Insights Live℠
Tax-smart wealth strategies

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TRANSCRIPT

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Jim Armstrong: Hello and welcome to the latest Fidelity *Insights Live*℠ webinar. My name is Jim Armstrong. I work on the webinar team here at Fidelity. Thanks for taking time out of your day to join us.

Today, we're going to be talking about some tax-smart wealth strategies that could potentially impact your financial life. Our panelists are ready to begin today's discussion. But before we do, I do want to mention that Fidelity doesn't give tax or legal advice. So nothing we talk about today should be interpreted as tax or legal advice. The information we provide is going to be general in nature, and it might not apply to your situation. If you do have tax or legal questions about your specific situation, we encourage you to talk to your tax professional or to your attorney.

All right. We're ready to get going today. We've built today's discussion entirely around many of the excellent questions that the audience sent in when you registered. So based upon your input, our panelists are going to be talking about a wide range of things, including but not limited to tax-smart investing, Roth conversions—lots of great questions about that—other Roth strategies, charitable giving, the upcoming election, of course, and a whole lot more.

Before we get going, though, I'd love it if each of our panelists could just spend 30 seconds to a minute or so introducing yourselves, talking about the work you do at Fidelity and the perspective you bring to today's conversation. So Michelle, we'll start with you.

Michelle Mahan: Thank you, Jim.

I am a vice president wealth planner at Fidelity Investments. And I've been at Fidelity now 20 years, working face-to-face with our clients as an advisor in the branch system. I currently support clients and their families that desire a deeper level of planning and a one-on-one relationship.

JIM: Excellent. Thanks for joining us today. Naveen?

Naveen Malwal: Hi, I'm Naveen Malwal. I'm one of the institutional portfolio managers at Strategic Advisers—a mouthful there—but I'm part of an investment team that manages millions of accounts here at Fidelity Investments, including some taxable accounts. Today, I'll be sharing some of the strategies we use to help our clients save on taxes over time.

JIM: Super important. Thanks for that. And Sandy?

Sander "Sandy" Bleustein: Yes, I'm a vice president advanced planner here at Fidelity. By background, I'm a CPA. Also a CERTIFIED FINANCIAL PLANNER® with 39 years in the wealth management business. And here at Fidelity, I educate our clients on financial planning strategies.

JIM: Got it. And Sandy, we'll stick with you as we dive right into probably one of the most popular topics. One of the most common questions we got from folks when they registered makes a lot of sense given what's going on in the news these days—the elections coming up in November.

Sandy, a lot of people watching right now are trying to figure out what changes, if any, could be on the horizon. So how would you say clients should be thinking about the upcoming election and their taxes specifically?

SANDY: Sure. So as I have my planning conversations with the clients, many say they want to wait till after the election before they do any additional planning. One of the things we're aware of is that next year, this law does sunset. The Tax Cuts and Jobs Act of 2017, also known as the TCJA. And that could result in potential increases in both income and estate taxes.

So for example, if the law does, in fact, does not get extended, we're going to see the estate exemption drop from currently it's over $13 million to over $27 million for a married couple to $7 to $7.5 million per person, $14 to $15 million for a married couple. And so what I tell clients is if you wait, getting in to see an estate planning attorney could be difficult if you want to do some gifting strategies.

So they're going to get very, very busy. So waiting till after the election, it may be too late. So I've also found with many years of planning that I've done that a lot of this tax planning strategies, such as gifting, makes sense for your situation, regardless of whether or not the tax laws change.

JIM: All right. So I hear you not—don't wait for an external event. Be proactive. Start. If you're thinking about doing it, get to work, right? Don't wait for an external event to prompt you or react to something else.

But, but Michelle, what about the situations in which a client maybe hasn't really incorporated any tax planning into their wealth strategy before? It can seem—well, it is—pretty overwhelming to start from scratch. So how do you get going?

MICHELLE: Yeah. So first off, Jim, I want to just have a conversation to level set. Where is your comfort level with talking about taxes? Do you have a comfort level in regards to tax planning within your investment strategy? Is it simply just filing your taxes on an annual basis? We may uncover that taxes have been a topic that you have been deliberately avoiding or simply just never realized this was an area that would affect you.

I like to assess the clients' holdings to help them determine what may trigger taxes now and what may trigger them in the future. I will also discuss the impact of current government policy on their strategy and potential impacts down the road. I will utilize a cash flow analysis. It illustrates what the picture might look like from an income perspective. Lots of strategies that can make a difference. For example, asset location.

JIM: Perfect. OK. I want to pause you there because again, there's a lot of jargon there. There can be a lot of jargon during conversations like this. And you're likely to hear us talking about asset location and asset allocation, which sound frustratingly similar, Michelle, but they're very, very different things.

MICHELLE: Oh, yeah. They absolutely do, don't they? And many of my conversations—again, we'll hit the pause button, and we'll say, let's discuss asset allocation first. And this is about dividing a portfolio between asset classes like stocks and bonds, which may have different tax implications. Asset location is not the same as asset allocation. It's the act of being deliberate in where you hold certain types of assets.

And what I mean by that, do you hold those assets, like a mutual fund or a stock, in your IRA, or do you hold them in your non-retirement account, which is exposed to taxes? And I do like to understand a client's preference around this topic. Sometimes, it's by luck that certain assets land in certain locations. And others? It's by design.

JIM: All right. Luck sounds less preferable to design, I think. But in general, another word for that is probably *strategy*.

And Naveen, I'll turn to you now because of the words used in the questions that our viewers sent in, *strategy* was probably among the most common we heard. I'm looking at some of the questions now. "What are some effective tax strategies?" A nice general question. "I'm looking for a strategy to protect my assets while reducing my tax liability."

So can you put some numbers, Naveen, around these types of questions to explain the long-term value of incorporating tax-smart strategies?

NAVEEN: Yes. To Michelle's point, not everyone has deeply thought about taxes or considered this as part of their plan over the years. And some might think the numbers aren't that big. But let's look at a study from a company called Morningstar. They went back and looked since 1926, what might have been the potential impact of taxes on investors. So on the left side of the chart, you'll see a pair of bars. One is showing you stock returns over that time frame. About 10% a year over that time frame. They're almost a 100-year time frame. So very nice returns for stock investors.

Next, there's another number, 8.2%. That is showing you what the return was after taxes. So almost 2% of the return they lost to taxes—tax costs. And that 2% might feel small to some people, but another way to think about that is if you take that 8.2% and 10.1% and divide them by each other, wow, that's a 20% gap. So almost 20% of your return has been given away to tax inefficiency by not being strategic about managing taxes over time.

The story is even more dramatic for the bond investor. So bonds over time generally do return less than stocks. They're also generally less risky, less volatile as well. But here, bond investors have done pretty well for themselves, generated a little over 5% before paying taxes.

But with bonds, they're typically less tax-efficient than stocks. So you can see a pretty big drop from what they made before tax to after tax. By over 2%, the gap is there. And again, if you divide one by the other, nearly 44% of that initial gain before taxes was lost to tax costs over time.

So those are significant numbers in my mind. And that can compound, especially after years and years of not paying attention to this. That can add up to thousands or tens of thousands, if not more, of potential lost returns that the investor left behind because of tax inefficiency.

So a lot of the topics we'll be discussing today will hopefully give investors some ideas on how they may be able to close the gap they see either for their stocks, or their bonds, or other investments in their portfolios.

JIM: Yeah. Thank you for that, Naveen. That's exactly what I was thinking as I was looking at that chart. It's stark on the chart, but then when you think about it, played out over decades, it gets even more significant. So, Michelle, I want to revisit what you talked about a moment ago in terms of asset location—where someone chooses to hold their assets. Talk about that, please, and dive a bit deeper.

MICHELLE: Absolutely. So this makes me think of many client interactions that I've had over the course of time. Picture it, the beginning of the new tax calendar year and you as an investor might reach out to me and ask, why are my taxes going up?

Well, this is a specific situation where tax location came into play. And I'm going to talk about a mutual fund. A mutual fund that pays out capital gain distributions or may have a high turnover rate may be inefficient to hold in a taxable account.

This is because the mutual fund generates taxable income for the investor. Some of these capital gain distributions may create unfavorable tax outcomes for the investor, and possibly bumping their tax bracket higher and for some retirees, impacting their Medicare costs.

I have been present for many of these surprises in regards to discussions with clients and it is an unfavorable surprise. So consider holding these assets in an IRA to potentially avoid those capital gain distribution impacts. Individual stocks and ETFs can be much more efficient assets to hold in a non-retirement account. Those vehicles have different turnovers and tax consequences compared to a typical mutual fund.

JIM: Thank you for that. Naveen, I'd love to go back to you to talk a little bit more—again, the word *strategy* ringing in my head based on all the questions we got from viewers. Talk a little bit more, if you could, about strategies designed to help manage those tax implications inside of an average portfolio.

NAVEEN: Sure. And you'll hear a lot more from Sandy and Michelle on this too, but just in terms of managing the investment portion of this, there's a number of strategies an investor can use. Here I want to share a visual that can list just eight of these strategies that are available.

There potentially are more, but I work with over 100 investment professionals here in Boston and in Denver, some in Ireland and other parts of the United States and dozens of them focus on these types of strategies to help our clients get better after-tax results.

It's a pretty long list. I'm not going to detail all of them here on this page, but I can break them up into two categories. The first category revolves around setting up the account. So first of all, moving the existing asset of the client, whether it's already at Fidelity or come from the outside, how can we bring their account in line with a good asset allocation, as Michelle said, the mix of stocks and bonds and other investments while not incurring a lot of tax gains?

So doing that in a way where it does not generate a lot of trades or selling and realizing gains over time. The other piece of this goes back to something else Michelle touched on is investing in tax-efficient investments. So Michelle gave you a couple of examples already.

Another classic example is in bond investing. Many bonds are actually tax-inefficient. So you pay the tax on the income coming in every six months or so. However, municipal bonds generally are very tax-efficient.

For most investors, they are exempt from federal taxes and depending on where you live, state, city, they may also potentially be exempt from state and local taxes. So that's an example of tax efficiency. And I agree with Michelle. This is something you can apply even to your stock investments.

Some stock funds do generate a lot of trades and gains year in and year out because the portfolio manager strategy is much more active, a lot of buying and selling happening, whereas other managers or other strategies are more buy and hold by nature and they tend to be more efficient. So those are more desirable investments to have in accounts that are taxable so the tax cost can be lower than something that is perhaps less tax-efficient.

JIM: And those techniques strike me, Naveen, as ways to build a nice foundation for a tax-smart portfolio. What do you do to manage it after an investor is up and running though?

NAVEEN: Right. So why do I have dozens of people looking at this day in and day out? There's a lot of maintenance that goes into this. So once the account is up and running, there's a lot of stuff that we can still do to vigilantly make sure we're doing everything we can to be tax-efficient over time.

So some of it is just maintenance over time. As stocks and bonds rise and fall, we typically look to realign the portfolio to its long-term target. So after, say, a strong stock rally, a portfolio that started off as half stocks and half bonds might be more like 55%, 45% stocks, bringing that back to 50/50, which lines up with the client's goal and risk tolerance.

We want to do that in a tax-smart way, where we're perhaps selling off investments that are either at a loss or a small gain to buy other parts of the portfolio to bring it back in line. Similarly, the client is looking to get some money out of their account, we follow a very similar mindset. How can we get the money to them without incurring a lot of gain?

So here, again, focusing on investments that are either at a loss or small long-term gains can be more tax-efficient than just grabbing something willy-nilly out of the portfolio and selling it that way. So that's some part of the maintenance.

Another big part of this is managing distributions. So towards the end of the year, in the third, fourth quarter, we start to get updates from different fund companies on their estimates of how much the distribution might be for some funds out there.

And this can be helpful to look at for two reasons: one, if you already own a fund, we will then look at the potential distribution and think about is this a strategy worth hanging on to? If it's going to be a large distribution and it's a fund that we're not as in favor of as anymore, perhaps that's something we do pull out of the client's portfolio and look for something else instead.

Or the other way we can use this research is to avoid funds that have said their gains are going to pay out a pretty big distribution this year. So why not wait till the distribution has been paid out before potentially acquiring that fund?

And the last thing I'll cover on this list, this glorious eight-circle strategy here, is tax-loss harvesting. And tax-loss harvesting is a strategy an investor can use to basically take advantage of market volatility or the ups and downs in the market to potentially generate some tax benefits in the current year or in future years for themselves.

JIM: So let me actually sneak another question in here, Naveen, because we got a lot of viewer questions when folks registered about tax-loss harvesting. So can you just spend another minute or two walking us through how exactly that works.

NAVEEN: I can. And this will be a preview. So I encourage you to discuss this with your tax advisor. Do your own research on this as well. It can have a lot of little technical concerns around this. But at a high level, the general idea is the tax code does allow investors to use realized losses in their portfolio to potentially offset tax liabilities in other parts of their lives.

So let's take an example to bring some of this to life and get away with some of the jargon I'm using. All right. So let's say we have an investor who buys a certain stock at the start of the year and after the recent sell-off, they're not as enthused about owning it. So they sell that stock out of their portfolio and by the time the trade settles, they have realized a $5,000 loss on that investment. So that is unfortunate.

However, from the tax code perspective, there is potentially some benefit to be had from that. So one, the first $3,000 of that loss, the investor may use to offset ordinary income in the same tax year. So the first $3,000 is available, only up to $3,000 to offset ordinary income.

The balance of that, so of the $5,000 loss, let's say $3,000 was used to offset the income, there's still $2,000 left. That leftover $2,000 can be used to offset realized investment gains in either the same tax year or at any time in the future. There's no expiration date on that portion of it. So that's how using tax-loss harvesting can help with market volatility actually get some benefit for it for the investor.

Now, with the proceeds from the sale of that security, the investor is more than welcome to go back into the market, but here's where they have to be careful and thoughtful about it. And here's where talking to a tax advisor can be very helpful. The rules do say you cannot just buy the same security back too soon, or essentially the same security back too soon.

There's time frames around this and different limitations. But generally speaking, one can invest in a different part of the market or perhaps a different asset class altogether without as much of a concern there. And therefore, they are still invested in the market.

The makeup of the portfolio perhaps hasn't changed all that much, yet they've been able to harvest this loss and use it to have an actual tax impact either in the same calendar—or I should say same tax year, or in the future at some point as well.

JIM: Got it. All right. Thank you for that walk-through there. Sandy, I want to shift to you now and ask a little bit about taxable gains because certainly, some amount of taxable gains are going to be unavoidable. So knowing that, accepting that, what strategies can you talk about that might help us manage those investment gains?

SANDY: Yeah. So many times, a smart investing decision does require the sale of that appreciated position, resulting in the gains and therefore, unfortunately, an increased tax bill. And as Naveen mentioned, though, if we have maybe some losses we've already recognized, we can help offset that.

Another strategy may be for those clients that are charitably inclined is making a charitable contribution. However, due to the current level of the standard deduction, a lot of our clients aren't able to itemize and may not receive the full benefit of that charitable contribution.

So in those strategies, though, we can use a strategy called *bunching,* when you can make several years of charitable contributions in one year to a public charity that's sponsoring a donor-advised fund, also known as a DAF, such as Fidelity Charitable®. You get the potential deduction when you make the contribution, and this higher level of charitable contributions can get you over the standard deduction and therefore help offset the income tax bite from that gain.

And in addition, now, the client or donor has a ready reserve of charitable funds to use to support their charitable causes either now or in the future. So when contributing to a DAF, long-term appreciated securities are a great asset to gift since you'll no longer have to pay capital gains tax on the sale of the security.

A benefit whether you itemize or not. So as an example, if you make a contribution of that security to the DAF, typically, it's sold right away and then you have reinvestment options. So if you have highly appreciated stocks in your portfolio, like a lot of these tech stocks that we hear about all day long, this could be a great strategy to consider for diversifying out of those positions.

Another strategy, and this ties into the estate planning for those clients looking to diversify out of a concentrated stock position, is a charitable remainder trust. Once the charitable remainder trust is set up, you can gift appreciated securities to the trust.

When you set it up, you select an annual payout rate, the minimum by law being 5%. The trustee of the charitable remainder trust typically will sell the appreciated security right away and reposition the proceeds into a diversified portfolio.

So let's say the client, when they set it up, has chosen the 5% minimum payout rate. The trustee must distribute each year to the client, regardless of earnings or growth in the trust, that 5%.

Another potential benefit of contributing to this charitable remainder trust is a potential income tax deduction of the projected remainder value that will be left to charity at the end of the trust term, which can either be a set number of years or it can be the client's lifetime.

JIM: You mentioned, Sandy, DAFs, donor-advised funds. Can you talk just a little bit more about how those work in practice?

SANDY: Sure. So a DAF can be compared to say, a charitable investment account in terms of its potential for both tax benefits and philanthropic impact. And it really works in three very simple ways: one, give; two, grow; and three, grant.

So give. When you contribute to the donor-advised fund sponsor, you're eligible for tax benefits like the ones we discussed earlier. Grow, funds are then invested based on your risk tolerance and timeline with a potential for tax-efficient growth.

And grant, you have terrific flexibility to recommend grants from this account to your favorite charities. Anything from your alma mater, or your local food bank, to maybe sponsoring a friend in a charity race. It's worth noting that there are donor-advised fund sponsors who really don't have any minimum balances and don't have any minimum amounts that you have to contribute to the account.

JIM: Got it. One more quick follow-up for you, Sandy, if I could. At the risk of stating the obvious, managing tax brackets, trying to predict where you're going to land can be tricky at best, particularly for folks who've got these kinds of occasional events in their financial lives like stock vesting. So could you spend a minute or two talking about charitable donations through the lens of timing and why that matters.

SANDY: Sure. One of the great benefits of the DAF is it allows you to time your deductions. So as a client has a big income year, maybe from the sale of a business or as you mentioned, stock plan vesting, the client could make a large contribution in that year to potentially offset a portion of that income.

Another alternative for those clients that are maybe selling a business or investment real estate is that you could potentially contribute all or a portion of that asset to a DAF. Here at Fidelity, we can work with a client and their tax advisors prior to the sale to structure that. The portion of that asset that's contributed to the DAF can potentially offset the large income tax liability that results from the sale.

But due to the complexity involved of a gift like this, as I mentioned, you need to get your tax advisors, typically CPA attorneys involved. You really don't want to wait till the end of the year to implement this strategy.

JIM: And thank you for acknowledging the complexity of all this. I really do think that that's something—I'm sure people watching right now are trying to wrap their heads around. It's complex to begin with and it has the potential to get even more complicated, Michelle, for example, when you're working with a family that's got multiple retirement accounts plus some non-retirement accounts, how do you help herd all of those cats?

MICHELLE: I love how you said that, Jim. So this is where I get to selfishly talk about one of the most exciting things that I think that Fidelity does right now. It's called the unified managed household. And really what that is, if I could sum it up in one word, it's holistic, OK?

This is where we're going to look at your different types of accounts: Roth IRAs, traditional IRAs, non-retirement accounts. We're going to look at them as one holistic goal. And what we're going to employ here is asset allocation, of course, the typical investment strategy that you all might be very familiar with, the mix of stocks and bonds and cash. But now we're also going to be deliberate with asset location.

What accounts do you have and where should we hold specific assets to be tax-efficient? So I am a visual learner, so let's throw up an example of how this might work. So what you see here is an example of the Millers.

They have about $1.75 million set aside for their retirement goal. Now being at the goal level, this might include retirement accounts, Roth IRAs, and perhaps non-retirement accounts. So what we're going to do here is we're going to reallocate.

So that asset location is very critical here. We're going to be tax smart. We're going to hold some of those inefficient assets in your IRAs because they are tax-sheltered. We're also going to hold some of those efficient assets in your taxable accounts.

So where we're going is we are meeting the goal-level asset allocation. However, we are doing it across multiple accounts so that you are not only meeting your risk level, but you're also doing it in a tax-efficient manner.

JIM: On this topic as well, how do you and your team help clients move to a more tax-efficient strategy without potentially incurring those big gains?

NAVEEN: Yes. This is potentially a stumbling block for some investors who may be considering these strategies and they open up their account and they shake their head saying, this can't be for me. I have so many positions here I've held for a long time and they're at a sizable gain, I can't afford for someone to come in, sell everything off, and then start from scratch.

The good news is the team here has had decades of experience managing accounts and transitioning accounts into alignment with perhaps our view on how to manage these tax efficiently. And with that, a lot of our new clients are surprised at how much of their existing portfolio actually doesn't change all that much.

So our approach—the team uses an approach here of trying to build around the client's existing portfolio. And in many cases, the clients typically coming in already have a mix of different types of stocks, bonds, US, international, maybe some bond exposure as well. So a lot of the positions can stay where they are, and it's about working around the edges of that to fill in some gaps or make some adjustments.

And there's also the option for the investment manager here to be thoughtful about not rushing into this. So they can wait, perhaps, a few weeks or months for certain positions to go from a short-term gain to a long-term gain, as that can potentially reduce the tax impact of any trading.

And they may also take a longer time to adjust the portfolio, say as long as over three tax years. This is especially true if the client is coming in with a stock or two or other positions that are, quote "more concentrated" in their portfolio, but more importantly, are sitting on some sizable gains.

By spreading out the gradual reduction of those positions over a longer time frame and perhaps letting market volatility do its thing where you can harvest some losses along the way, it potentially reduces the tax impact of those trades rather than doing them all in the first few days of the account or transitioning from wherever it is into the tax-managed strategy that our investment manager is trying to implement for the client based on their goals, their risk tolerance, and other things they've shared with advisors like Michelle.

So it's a very comprehensive, very thoughtful approach. And I find generally speaking, many clients are pleasantly surprised to see this wasn't going to be as expensive tax-wise as they thought to move into a strategy here at Fidelity.

JIM: Always good to find that out for sure, so thanks for that, Naveen. We've mentioned, at kind of a high level, retirement income a couple of times. So I'd like to dive a little bit deeper on that because I know a lot of people watching right now are concerned with managing taxes on retirement income, especially when it comes to withdrawing from pretax accounts, like IRAs. So, Sandy, can you explain what charitable options are available there?

SANDY: Sure. So one very popular option is the qualified charitable distribution rule. This came about back in 2005 after Hurricane Katrina, if anybody remembers that awful hurricane that hit us at Cat 5 down in Mississippi.

So this allows clients that must take required minimum distributions. The RMD age back then was 70½ to direct all or a portion of it to a public charity and therefore reduce their adjusted gross income. This year, the QCD amount is actually $105,000 per person or double that for a married couple.

So the nice thing about the qualified charitable distribution is for those clients that can't itemize, they still get a reduction in income. So it does reduce their adjusted gross income. Unfortunately, QCDs cannot be contributed to either a donor-advised fund or a private foundation.

The reason for this is back in 2005 when Congress introduced this, they wanted to make sure that charities got the money right away so it could be used to help people. Both donor-advised funds and private foundations, not all the money has to go right away to those public charities that are face-to-face helping people. So that's why those were excluded.

In addition to the QCD, sometimes a combination of the QCD and contributions to a DAF in the same year may make sense depending on that client's tax situation. So working with your advisor or tax professional can help you weigh one or a combination of those strategies that can best be suited depending on your situation.

And one last point with the QCD, even though the RMD age is now 73 or 75, depending on your year of birth, you can still take advantage of the QCD at 70½ even though you don't have a required minimum distribution then.

JIM: Got it. All right. Thank you for that. Let's pivot the conversation now to other than the election, certainly the most commonly asked about or commented on topic. It's Roth conversions. It is a perennially popular topic.

I'm looking at some of the questions that came in now. "I'm looking for information about Roth conversions." "Tell me about Roth IRA advantages over traditional IRA." "I'm just looking for pointers on conversions to Roth IRAs." Sandy, start us off. This is such a popular topic.

SANDY: Yes. There isn't a day that goes by in one of my client meetings that we are certainly talking about Roth conversions. So a Roth conversion is when you move money from an existing taxable IRA to a Roth IRA.

So the pretax balances that are converted to the Roth are subject to ordinary income tax in the year that you do that. There are no income limitations when doing a Roth conversion, though, unlike if you're working and want to make annual Roth contributions.

So one of the major benefits of a Roth is you are not required to take required minimum distributions during your lifetime. So if you don't need those funds to live on, it can grow income tax-free, potentially a great wealth transfer strategy.

And if you're married, you can leave it to your spouse. They can roll it over to their own Roth, and they also don't have to take required distributions. At death, though, when it's left to a non-spouse beneficiary, they are required to take distributions at that time.

Another potential benefit with a Roth is that it can help with tax-bracket management. Let's say that you're at the top of your marginal bracket and working with your CPA and say doing tax planning and you need additional funds to pay bills, but you don't want to pay additional income tax as it pushes you into a higher marginal bracket. Maybe you should consider a qualified tax-free distribution from your Roth IRA.

JIM: OK. Michelle, I want to turn to you now. A healthy-sized subset of the Roth conversion questions had to do with "help me figure out if this makes sense for me." Here's one question word for word, "Is a Roth conversion really worth doing?" So, Michelle, how do you help someone like that wrap their brains around whether or not this is something they actually should do?

MICHELLE: Absolutely. A lot of this, I find, ends up being water cooler talk of should I do a Roth conversion, should I not? And first off, it's critical for me to understand if there is a value gained by implementing the strategy.

At first, I utilize my planning software to model out potential Roth IRA conversions. And my software will tell me a couple of things. What is your impact to taxes now and later? How much taxes will this cost you now and how much potentially can you save later by doing this now? And also a potential impact to your heirs.

And what I mean by that is leaving a Roth IRA to your heirs can be a very tax-efficient but tax-friendly vehicle to leave for loved ones. And what I mean by that is you might be aware that the laws were changed, that we can no longer stretch out required minimum distributions over the course of our lifetime for non-spouse beneficiaries.

You must spend that down within 10 years. So that rule does apply to Roth IRAs. Your non-spouse beneficiaries must withdraw money within 10 years. However, those withdrawals will not be considered income to your heirs.

I also like to discuss something we call *tax appetite*. How much is the investor willing to endure in regards to fast forwarding some of their tax obligation? And does policy play into this for you? Does legacy and estate planning play a part in this? And also, how about health care planning? Consider discussing this with your tax advisor for sure. And they understand your complete tax situation and can provide some tax advice on this.

JIM: *Tax appetite* is a great phrase. I can imagine some people have some pretty strong opinions about what their appetite is. But I love your framing of it because this idea is Roth conversions are really all about making the most educated predictions for when you can best handle your tax burden, right? There's a tax burden associated with it. It's just a matter of figuring out when in your lifetime you can handle that.

And as you mentioned, health care planning is probably one of the biggest variables. And we got this question I wanted you to take in. It's excellent. The person says, "Does it ever make sense to make a large Roth conversion even if it causes a Medicare premium surcharge?" In parentheses, IRMAA. "How would one decide?" So, Michelle, here's somebody who has all the facts at hand. They know what they need to be worried about. They just don't know what to do next.

MICHELLE: Oh, absolutely. So this is one that I have experienced. This is one that I see quite often. So when it comes to the Medicare surcharge, IRMAA, that is not forever. That is a one-time surcharge on your Medicare premiums.

So some people like to quote unquote, "football spike" their Roth conversion so that they can get more money, as much as their heart's desire into a Roth IRA in one calendar year. This does cause more taxes in that year. This does affect your Medicare premium surcharge.

And this is where I do like to pause again and understand your preferences. Is this something that you are trying to do for legacy purpose or for future tax planning purposes? But the health care discussion is one that takes center stage for many investors, whether it's our own personal health care journey or someone near and dear to us, that we all understand that the cost of health care is tremendous.

And therefore another way to consider the benefit of having a bucket of Roth IRA funds is to tax efficiently fund future health care costs needs. Long-term care is very expensive, as we all know, and the idea of having to pull from a tax-free source can be very helpful later in life.

And unfortunately, taxes in the future may be higher, and especially higher for those that file as a single taxpayer. As you may or may not be aware, IRA distributions are included in your modified adjusted gross income.

That counts towards your Medicare premium bracket. The income related monthly adjustment amount or IRMAA is an additional charge that high income earners must pay on top of their Medicare Part B and Part D premiums.

However, Roth IRA distributions do not affect your Medicare IRMAA bracket calculation. Hence, there may be a benefit to building a tax-free bucket that not only grows tax-free, but can help pay efficiently for those possible medical costs in the future.

JIM: Absolutely. Hey, Sandy, I'm curious what, in your practice, you've seen as the biggest consideration that folks have when it comes to whether or not a Roth conversion might make sense for them.

SANDY: Yeah. So when evaluating, we like to see does this make economic sense? And one of the considerations that I think clients really haven't given a lot of thought to is do we have adequate cash on hand to pay the tax? Money sitting in money market as an example or a savings account.

Because if we don't, well, we have to raise the cash somewhere. Either we have to take more money out of the IRA to pay the tax on the conversion, which really usually never makes sense, or maybe we're selling off appreciated securities.

So certainly if we're tax managing the portfolio, maybe we can help offset that bite. But those are the things that you have to consider. Because if we have to raise cash by selling things, taking more money out of the IRA, we're paying tax on tax.

It usually extends or almost always extends to break-even point where it no longer makes sense to do that Roth conversion. If you're going to convert an IRA to a Roth, as mentioned previously, you can make a charitable contribution in that year maybe to potentially offset that income tax liability.

And a couple other considerations is we have this pending tax law sunset where we're going to see the income tax rates potentially go up in 2026. So maybe accelerating the Roth conversion strategy into maybe this year and next year when the income tax brackets or rates are potentially lower.

And then, of course, as Michelle mentioned, we've got to take into consideration how does that affect our modified adjusted gross income, which impacts our Medicare premiums, right? So it could affect that and that obviously impacts the economics of the decision as well.

JIM: Thank you for that. Michelle mentioned legacy planning. And so Sandy, I want to get your take on that because for some clients, that certainly also involves tax planning. So I'd love to hear your thoughts on some strategies for folks watching who might be concerned with estate taxes. In particular, we've got a handful—actually, more than a handful of questions. I'll share a few of them now from folks when they registered.

Someone wants to know how to transfer assets to children "while I'm still alive." Somebody else wrote in and said, "I'm interested in using trusts for asset transfer." And then another person said, "How can I use trusts and annual gifting to help make the eventual transfer of my assets more tax-efficient?" A lot of ground to cover there, Sandy.

SANDY: Absolutely. So for those clients that may be subject to estate tax, every dollar of income and appreciation they're currently not spending, the government's now a 40% partner. Pretty depressing to think about that, right? Especially if you're working, you're working hard all day long and now you come home and 40% of the net earnings are going to Uncle Sam if we die.

So gifting assets that aren't needed to provide for your lifestyle can remove that appreciation from your taxable estate. So in planning with our clients, we like to break the wealth down into two buckets as it were.

One, I like to call lifetime income needs, or lifetime capital needs. That's the money clients need to live their life, right? They usually don't want to gift money and find out one day, oh, I need that, now I have to go and ask my children for money. Typically aren't very comfortable doing that.

So that's the money we need to live our life and maintain our lifestyle. And the second bucket is the wealth surplus. And this is the money we can use for gifting. So the strategies include an $18,000 annual exclusion gift to individuals. And if you're married, you can do $36,000.

So between children, grandchildren, you have 10 beneficiaries, each one of those, as a married couple, you can give each of them $36,000 each year. So this is each and every year. And this annual exclusion amount does adjust annually for inflation, but it only goes up in $1,000 increments.

So the last couple of years, we did see a jump. We may not see it go up next year because inflation has tamped down a bit. So if we do have clients who want to gift in excess of the annual exclusion amount, so one way is they can make a large gift now, say, to an irrevocable trust, of their lifetime exemption.

So for our very wealthy clients, they could give $13.6 million, if they're married over $27 million, and move that money out of your estate. And as I mentioned, making these gifts to an irrevocable trust is a common strategy.

Another great strategy is funding 529 plans. So there's a nice benefit of the law where you can gift, in essence, prepay five years of annual exclusion gifts in year one into a 529 account. So this year, an individual can gift $90,000 to a 529 for a beneficiary, or if you're married, $180,000 to that beneficiary.

So another strategy is you can pay tuition and medical expenses on behalf of another. So as long as that is paid directly to the provider of the service, this doesn't count against your annual exclusion amount or your lifetime exemption. So as an example, we see a lot of grandparents paying private school and college tuition for their grandchildren. So just a great strategy.

And as a reminder, I mention that because of the sunset in the tax law next year, we are going to see that potentially lower exemption in 2026. So for those clients who have the ability to give that entire $13.61 million, it makes sense because if let's say they gift $13 million this year and then we're sitting here in 2026 and the exemption goes to $7 million, well, they were able to gift $6 million they would have lost. A terrific strategy for those clients that can afford it.

JIM: Yeah. A really good reminder there. Thank you for bringing that up again about the potential change—not guaranteed change, but potential change to that tax law. Any other trust-related strategies that clients might want to consider, Sandy?

SANDY: Yeah. There's actually quite a few. So one, giving that lifetime exemption, say, to an irrevocable trust. There are different types of irrevocable trusts. We mentioned the charitable remainder trust previously. There's charitable lead trusts. There's grantor retained annuity trusts.

There's other strategies that are non-trusts, say an intra-family loan. Or you can maybe use family limited partnerships or limited liability companies to leverage gifts as it were. Gifting of a residence to a qualified personal residence trust.

So those of us in the estate planning profession, as it were, we sort of call it the alphabet soup of gifting strategies. Everything from CRUTs, CRATs, to FLTs, to GRATs, to QPRTs, et cetera, et cetera. So mentioning jargon, right? You go to the estate attorney and they're throwing out all this alphabet soup and—we do a great job here at Fidelity, I believe, educating our clients on these strategies.

And one last reminder, it does take time to implement these trust strategies. So one more reason not to wait. It may make sense to just go ahead and get the documents drafted, get teed up to make gifts, but you could still wait to ultimately fund those gifts.

JIM: Yeah. That's great context there, Sandy, because as you do start to learn about this, it does seem pretty close to impenetrable to wrap your brain around it, which is why to go back to your very first answer from a few minutes ago, don't wait, right? Start the investigating now, start the discussions now, planning and doing now so that you're not pressed for time later.

Speaking of pressed for time, that was an accidental but fortunate segue. We're just about running out of time, but I did want to squeeze another viewer question in for you, Michelle, because it really ties up nicely what we've been talking about here.

This person wrote in and said, "How can I reduce the tax impact of RMDs" those required minimum distributions, "given my age?" This person's over 75 and they think that Roth conversion seems to be out given their age. How would you answer that question?

MICHELLE: I get this question a lot and I don't want anyone to assume just because of your age, that just phases you out of considering this as an option for you. I believe that you need to do something in regards to your investment strategy to make sure that it impacts your overall strategy for the better.

And one of those things might be, again, as something Sandy said earlier on, your legacy. To benefit your legacy to your heirs, the Roth conversion very well might be something that we do need to keep on the table regardless of your age. Another way that you can consider is another thing Sandy talked about, was the qualified charitable distributions.

You can donate directly to a charity and that donation, even though it is coming out of your IRA, it does not go towards your modified adjusted gross income, which then relates back to that Medicare IRMAA surcharge on Medicare costs. So please don't count yourself out regardless of age in the Roth conversion conversation. It's worth just considering and talking about your personal situation.

JIM: Excellent. Love it. Thank you for that. As we start to wrap up—again, we've covered so much in such a relatively short amount of time. So I want to thank you, all three of you, for taking time to be with us today.

As we start to wrap up, I think it would be pretty helpful if you could just leave each of our viewers with a few key takeaways that you'd like them to leave this webinar having held in their minds. Naveen, we can start with you.

NAVEEN: Sure. So I outlined a bunch of different strategies investors may look to employ on their own, but many of these may be time-consuming or technical in nature, and we didn't review all the details today.

So some investors, if not most, may prefer to work with an investment professional on some of these areas. And as we've said time and again, please consult your own tax professional for advice and suggestions on approaching some of these strategies rather than doing it on your own based on today's webinar.

JIM: Got it. Sandy.

SANDY: Do not wait for the election to plan. In my experience, a well-planned strategy can often adapt to changes in the tax laws, making sense both now and in the future. And also, if you're charitably inclined, charitable gifting strategies can potentially provide significant income and estate tax savings.

JIM: Got it. And Michelle, last word goes to you.

MICHELLE: Yeah. I want to encourage all of you to identify your preferences and comfort levels with these topics. How do you feel about taxes? Do you have a tax appetite now and to possibly become more tax-efficient in the future? And do you have charitable wishes? And do you have preferences for lifestyle over legacy? So do your best to try to find your voice so that you can take advantage of what opportunities make the most sense for you and your family.

JIM: Absolutely these are your decisions to make. Makes a lot of sense. Thank you all three for taking time, as I mentioned, out of your busy schedules to be with us today. Fantastic insights for this audience.

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