GREENLEAF TRUST

Perspectives

A Greenleaf Trust Newsletter

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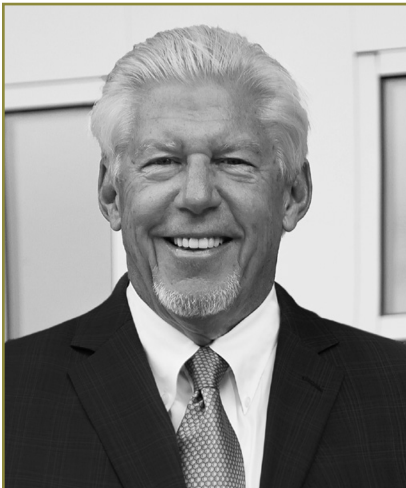

William D. Johnston
Chairman, Greenleaf Trust

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Economic Commentary

The very nature of our business requires that we have a thirst for research and a constant desire to understand whatever is impacting our economic, domestic and geopolitical systems. We always approach that discovery from our clients' side of the desk. What might our clients be reading or listening to? As a result of their interactions with popular culture media, what might they be wondering about? What relevant information might be important to them? This discovery process has always been one of the most stimulating parts of my career and I'm always thankful for the opportunity to engage in it. While the challenges are sometimes different in detail, each of the last three decades have offered what at the particular date and time might well have seemed like cataclysmic events certain to disrupt or perhaps change our economy and political system in seismic ways too difficult to resolve. The advantage of historical perspective is that the current disaster is likely to fade and a new one will take its place.

We began our relationship with the pandemic of COVID-19 recognizing that a playbook didn't exist for its resolution, but that our economic recovery was dependent upon successful mitigation of the disease. Recent focus on what appears to be a stalled vaccination rate has given way to some assumptions that we are failing in our effort to combat the virus. I'd like to offer a different perspective based upon a perhaps different view of the data. While the US fully vaccinated rate is now at 53%, the rate fully vaccinated among the most vulnerable is significantly higher. Among those 75 years of age and above, 89% are fully vaccinated. The numbers are even higher for those 65–74 years of age where 94% have received two doses of the vaccine. The largest age demographic of active workers ages 25-64 have been vaccinated at rates ranging between 68% for ages 25-49 and 80% for those in the age category of 50-64. To my eye these rates of vaccine adoption are impressive. If these rates of success are accurate then why are we struggling at a 53% rate for our total population? You have probably already arrived at the answer, those 18 and under are far less likely to be vaccinated and those under 12 are not likely to receive vaccine approval until December 31 of 2021. Recent FDA full approval of the Pfizer vaccine (previously given under emergency authorization) is not likely to

Commentary, continued

move the needle (no pun intended) for adult vaccination rates but might provide some greater comfort for parents when approval for those 12 and under is granted later this year. Recent polling has affirmed that most adults have settled in on their view of the vaccines and thus the results we see for those 18 and above are likely to be near the top of what we achieve longer term. It is likely that we will achieve an overall vaccination rate of near 75% when approval of vaccines for juveniles is granted though it is likely to be adopted along the same demographics as it currently exists. Unfortunately, one of our greatest successes in the vaccination rollout is to politicize the vaccination against the COVID-19 virus. The evidence of this politicization can be seen in the demographic data of who has and has not been vaccinated. According to CDC data and polling by the Kaiser Family Foundation, the majority of adults not currently vaccinated are under the age of 49, live in a suburban or rural location, are white, hold a high school diploma or less and identify as Republican. The importance of that data is the inference that when the vaccine is approved for those under 16 it will be the parent who will either make or heavily influence the decision for their child to be vaccinated. If that is the case then we can expect the under 16 demographic to mirror the vaccination rate of their parents which will make the total adoption rate of the COVID-19 vaccination substantially lower among school age students than polio, measles, mumps and whooping cough vaccinations. While the data also demonstrates that younger patients have better outcomes enduring and recovering from the disease, a lower adoption rate created by the politicization of vaccinations will add to disruptions in returning to normal classroom settings.

"Unemployment improved to 5.4% and is a full 1% lower than at the beginning of 2021."

Our economic recovery from the pandemic recession continues. The New York Federal Reserve's Weekly Economic Index (WEI) measuring consumption, production and employment data continues to show strength (+9.27 for the 13-week moving average as of August 26) even though it retracted from the 13-week moving average of +10.91 in late June of this year.

Unemployment improved to 5.4% and is a full 1% lower than at the beginning of 2021. Labor participation remained steady at 61.7% and long term unemployed at 27 weeks or more declined by 560,000, but remains 2.3% above the February low of 2020. Employment gains came in the expected areas of leisure, food and beverage, retail, education, hotel, arts and entertainment. The average work week held steady at 34.8 hours; however, overtime in manufacturing increased that category's level to 40.5 hours.

We are beginning to get some initial data from the 26 states that eliminated or substantially reduced state unemployment benefits while

Federal stimulus was being received. In some cases the states returned or refused the Federal stimulus and limited the benefit to state supplementary support. States implementing this strategy did so because their state legislators believed high job vacancies were the result of unemployed persons receiving a benefit higher than $15.00 per hour. Many state food and beverage as well as hospitality associations lobbied for this legislation. This type of legislation was recently implemented in June and thus, year-to-date we have only one month of data to examine and we always caution against conclusions based upon that little data. What is demonstrated though is that mixed results were achieved. States reducing benefits showed an increase in employment of 4.4% over states that continued to extend unemployment benefits. Workers in those states that gained employment earned $14 more per week than they received in weekly unemployment benefits; however, they spent $145 per week less than they had while unemployed. There will be much more analysis of data in future months, but on the surface we could say there was minimal change in jobs filled, minimal income benefit to those employed but a substantial change in consumption spending. Too early to tell the consequences of the action at this point.

"Workers in those states that gained employment earned $14 more per week than they received in weekly unemployment benefits; however, they spent $145 per week less than they had while unemployed."

Inflation has received a good deal of attention and was mentioned in Fed Chair Powell's most recent testimony before Congress. While Chair Powell acknowledged that 5% inflation was above the Fed's target, he urged both caution and patience at the near term view of year over year price increases. Instead, he spent time talking about a base effect of inflation that examines key components of inflation over a rolling 24-month period of time, particularly 24-month cycles that do not include recession or recovery cycles. He spoke at length about "recovery lag" and "pent up consumer demand" and the cumulative impact of logistical supply chain interruption. He also acknowledged that, while the US inflation rate was higher than the current G-7 rate, our stimulus investment was substantially greater than other G-7 countries. The overall message was that the inflation measured was transitory and heavily influenced but recovery lag pricing that will retract and be more normalized through base effect calculations spread over 24 months. Lastly, Chairman Powell called to attention that since 2001 we have been in a cyclical disinflationary time when GDP retraction cycles have been increasingly larger and recovery cycles increasingly weaker and urged that stronger growth, even when it included some transitory inflation, was much preferable to weak growth and weak inflation. I am always reminded that congressional testimonies by Federal Reserve chairs are viewed through a political lens. This time it was the Republican members of the committee that didn't like his testimony, but I think he got it mostly right.

Michael F. Odar, CFA®
President

Settling Our Estate

Recently updating our estate plan made me think about the actual implementation of the plan. After all, successful plans require attention and thoughtful execution. Do we want to burden our boys with it? If so, should we? Our plan isn't complicated, but will they actually know what to do? How long will it take? How will outstanding bills get paid? What happens to our personal property? How does probate actually work? It can be overwhelming.

Through many conversations with our team and a little experience of my own, I realized few estate plans are as simple to carry out as the printed words in a will and trust suggest. Settlement of even the most basic estate usually involves hundreds of individual tasks and actions, ranging from the simple (such as paying the decedent's final bills) to the complex (such as making important tax elections that impact future generations of beneficiaries). Estate settlement may entail months or years, depending upon its complexity and circumstances. Regardless, settlement requires timely and time-consuming attention to deadlines and details, care and prudent management of estate assets, and, above all, an unwavering commitment to the sacred duties of a fiduciary: honesty, impartiality among beneficiaries, and confidentiality.

By naming Greenleaf Trust to oversee the settlement of our estate, we not only alleviate burdens from those close to us, we may also preserve family harmony. Appointing one child, sibling, niece or nephew, for example, to serve in a fiduciary capacity to the exclusion of others can be a recipe for distrust and hurt feelings. Conversely, appointing a group of individuals to settle one's estate can be inefficient, impractical, and costly. I'm proud that Greenleaf's fair, impartial, and transparent treatment of all beneficiaries avoids the tension and conflicts that might otherwise arise between beneficiaries and those who serve as fiduciary.

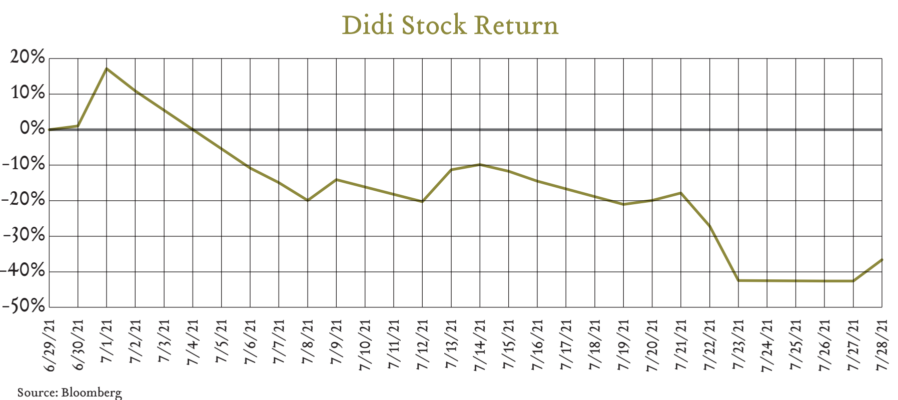
"Settlement of even the most basic estate usually involves hundreds of individual tasks and actions..."

Over the last couple of years and based on need, we have expanded our estate settlement team through the addition of new talent. Our team now includes five experienced professionals with diverse backgrounds solely focused on estate settlement. The larger team allows us to be more proactive, effective, and efficient. It's reassuring to us to know that team members that I know and trust at Greenleaf Trust will be handling the settlement of our estate. I hope our clients and their beneficiaries feel the same way.

China: A New Beginning or More of the Same?

Jacob A. Barker, CFA®
Manager Selection Analyst

Taking financial markets by surprise, Chinese authorities announced that the ride-hailing platform, Didi, was to be banned from app stores in China. This effectively severed the company's ability to add new users within the country. Didi, the Chinese equivalent to Uber, received this unwelcome news just two days after going public on the New York Stock Exchange, in what was the largest US initial public offering by a Chinese company since Alibaba went public in 2014. Unsurprisingly, the announcement sent Didi's stock price tumbling. The Cyberspace Administration of China (CAC) justified the action saying the company was illegally collecting and using personal information. However, skeptics of the communist regime believe that this action was taken as part of a newly emerging effort by China to reign in the power of some of the country's most influential companies. Whatever the reasons, the Chinese government's recent series of regulatory actions have rippled through the Chinese stock market and left many investors unsure of what to expect. Before we attempt to estimate the future implications of these actions, we must first discuss the events that have unfolded over the last few months and take a brief look to the past to gain historical context.



Source: Bloomberg

YESTERDAY, TODAY & TOMORROW

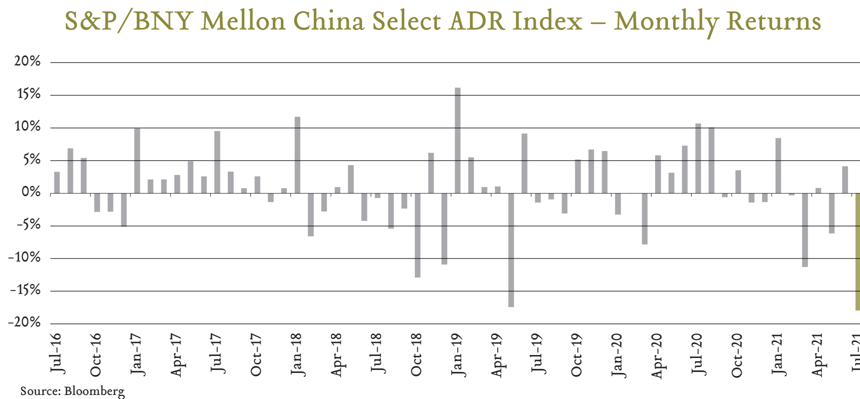
Over the past few months, China has taken concrete action to crack down on Chinese companies listed on foreign stock exchanges, particularly those within the technology sector. While the list of new regulations continues to grow, the ones that have had the greatest impact on market sentiment are provided in the following table.

Date	Law/Guideline	Overview
2/7/21	Antitrust Guidelines for the Platform Economy	Increases the authority given to regulators to monitor and prevent monopolistic behavior.
6/10/21	Data Security Law of the People's Republic of China	Specifies how data is to be collected, used, and protected. Changes how firms are allowed to share data across borders.
7/24/21	Guidelines for Further Easing the Burden of Excessive Homework and Off-campus Tutoring for Students at the Stage of Compulsory Education	Bans for-profit tutoring in core education. Existing for-profit companies within this roughly $120 billion industry must register as non-profit institutions.
8/20/21	Personal Information Protection Law	Places new restrictions on the collection and use of personal information by companies. Further restricts cross-border information sharing.

"… Chinese authorities announced that the ride-hailing platform, Didi, was to be banned from app stores in China… the announcement sent Didi's stock price tumbling."

China: A New Beginning or More of the Same?, continued

The increasing uncertainty within the market has resulted in a precipitous drop in the stock price of many of these firms. Rationalizing their decision to rewrite the law, China has cited the need to dismantle monopolistic companies, protect consumers, and promote equality. There are others who believe this is part of a larger effort by the Chinese Communist Party to solidify its position of power. To date, the technology sector has been the hardest hit, however a report released by Chinese officials on August 11 detailed plans to increase the scrutiny of all companies within "important fields" such as education, science, and technology among others. These events have caused the S&P/BNY Mellon China Select ADR Index (an index that tracks the performance of nearly all Chinese companies listed on American stock exchanges) in July of 2021 to experience the largest single month drop in over five years. Given investors' disdain for uncertainty, it comes as no surprise that financial markets reacted in this manner. However, this lack of regulatory clarity is unlikely to persist in the long run. So, to understand what may occur once the dust settles, we will now turn our attention to past experiences to see what lessons we can glean.



By Western standards, this recent upheaval of the regulatory environment is inconceivable, however within the context of developing nations such as China this degree of regulatory uncertainty is anything but uncommon. To gain perspective on the events unfolding in China, we have to look no further than the crackdown on the banking industry that occurred in the years leading up to 2010. In this instance, the Chinese government implemented a series of regulatory changes with the stated goal of protecting fair competition and promoting sound banking practices within the nation. Much like the changes being implemented today, there appeared to be other factors influencing these policy changes, namely weakening the standing of foreign competitors to prop up Chinese banks. While the abrupt regulatory changes resulted in a period of market turmoil and a reshaping of how banks could operate within the country, once the changes were fully implemented financial markets normalized and the investors that were able to ride out the storm were rewarded with higher returns. A similar series of events unfolded in the early 2000s when China reformed the laws governing financial institutions, resulting in a period of poor equity performance that was followed by a rally in stock prices. Whether or not these past experiences are directly transferrable to today's situation is unclear. As we will discuss

"Rationalizing their decision to rewrite the law, China has cited the need to dismantle monopolistic companies, protect consumers, and promote equality."

next, what is clear is that China did not go into this with its eyes shut, and if history is to repeat itself investors may be able to unlock value by simply riding out the storm.

Up to this point, we have discussed the events surrounding the current market volatility and deepened our understanding of how today's events compare to those of the past. So, naturally we must now contemplate what lies ahead. To accomplish this, it is paramount to first make it clear that China has benefited immensely from adopting free-market policies. The progress China has made in raising its population out of poverty is unmatched and is largely attributable to the opening of its economy and adopting free-market principles. Given the benefits realized by China it is hard to believe that it would be willing to kill the "golden goose." Provided that Chinese officials do not have a proclivity for self-harm, it is safe to assume that high-ranking officials weighed the pros and cons of these actions and concluded that the long-term benefits from reshaping the regulatory framework outweighed any short-term consequences. Due to this, we believe the reshuffling of regulations taking place within China will be inconsequential in the long run. This may even present opportunities for strategic investment in the short run. Warren Buffett, Chairman and CEO of Berkshire Hathaway and regarded by many as one of the greatest investors of all time, highlighted the potential benefits of uncertainty when he said "The future is never clear; you pay a very high price in the stock market for a cheery consensus. Uncertainty actually is the friend of the buyer of long-term values." We tend to subscribe to this long-term investment orientation and believe that our client portfolios are well positioned for the unfolding events.

"A similar series of events unfolded in the early 2000s when China reformed the laws governing financial institutions, resulting in a period of poor equity performance that was followed by a rally in stock prices."

INTO THE UNKNOWN

The actions undertaken by the Chinese government have shaken the confidence of many investors and the uneasiness may not be ending any time soon. As of this writing, the scope of China's efforts to revamp the laws governing publicly traded companies is unclear. While this uncertainty persists, we expect heightened volatility to remain. That said, we believe that client portfolios are well positioned to take advantage of this disruption through the actively managed mutual fund managers we employ. In addition, the temporary market aberrations should be muted at the portfolio level as the typical client's balanced portfolio (i.e. 60% stocks and 40% bonds) has less than 2.5% of their portfolio invested in Chinese securities. Given the above, we believe the best course of action is to sit back and, in this rare instance, hope that history repeats itself. In the meantime, we will continue to monitor the events unfolding in China and as always, we will keep clients abreast of future developments.

George F. Bearup, J.D.
Senior Legal Trust Advisor

Are Quiet Trusts Coming to Michigan?

One of the fundamental duties of a trustee is to keep beneficiaries reasonably informed with regard to the trust's existence and administration. That could be soon changing in Michigan.

The Michigan Trust Code imposes broad disclosure requirements on a trustee. Specifically, the Michigan Trust Code provides that a trustee must keep a qualified trust beneficiary reasonably informed about the trust's administration and also with respect to the material facts that are necessary to enable the beneficiary to protect his or her interest in the trust. In addition, a trustee must promptly respond to a trust beneficiary's request for information with regard to the trust's administration. A qualified trust beneficiary includes both the current beneficiary of the trust (the individual who receives distributions) and the beneficiaries that would be entitled to distributions from the trust if the current trust beneficiary's interest were to cease (the remainder trust beneficiaries). Consequently, the trustee's duty to inform extends to both the current trust beneficiary and the presumptive trust remainder beneficiaries.

When a trust becomes irrevocable, the trustee must provide the trust beneficiary with a copy of the trust instrument and also information with regard to the existence of the trust that will alert him or her as to their status as a trust beneficiary. The trustee must also provide periodic account statements to the trust beneficiary. The trustee's obligation to inform and regularly communicate with the trust beneficiaries cannot be eliminated from a trust instrument under Michigan's Trust Code. As a result, Michigan is considered to be a jurisdiction that does not permit quiet trusts where trust beneficiaries are "kept in the dark" about the trust, its property, and their rights under the trust.

> "A trust creator may fear that a trust beneficiary's knowledge of the wealth held in the trust can act as a disincentive for the beneficiary to pursue his or her own success..."

These fiduciary disclosure rules sometimes can frustrate the trust's creator. A trust creator may fear that a trust beneficiary's knowledge of the wealth held in the trust can act as a disincentive for the beneficiary to pursue his or her own success, which often is the case when the trustee holds substantial assets for a beneficiary. For example, if there is a young adult trust beneficiary, or a beneficiary with a known substance abuse or gambling problem, the trust creator may not want the beneficiary to know about the trust, its assets, or the income those trust assets generate, all for a good reason.

Some states, like Delaware, have adopted laws that permit a trust instrument to eliminate the trustee's duty to inform the beneficiaries for a period of time, a period often tied to the trust beneficiary's age, the beneficiary's parent's death, trust creator's death, or the occurrence of some other external event, e.g. the sale of the family business held in the trust. Currently the State Bar of Michigan has a group that is studying a possible amendment to the Michigan Trust Code that would permit some type of quiet trust.

The perceived advantages of a quiet trust include the following:

- It maintains confidentiality with regard to the trust creator's financial affairs and estate planning arrangements;
- It avoids the beneficiary's scrutiny of the trustee's investments and management of trust assets;
- It prevents the disclosure of information about the trustee's management of trust assets and, in particular, any family-owned businesses held in the name of the trust;
- It incents the beneficiary to behave in a financially responsible manner; and
- It protects the beneficiary from becoming the target of fraud, identity theft, and manipulation by others.

The drawbacks to a quiet trust are often viewed to be the following:

- It defeats a key purpose of keeping trust beneficiary informed so that they can monitor the trustee and ensure that the trustee acts in the beneficiary's best interests;
- If the trust beneficiary does not know about the trust or cannot obtain information about the trust, it may be impossible for the beneficiary to hold the trustee accountable;
- Without contemporaneous information about the trustee's decisions in the administration of the trust, it increases the risks of litigation at a later date when the trust beneficiary finally learns of the trustee's decisions, albeit long after the decisions have been made;
- Its presence, standing alone, may not be effective to discourage irresponsible or destructive behaviors by the trust beneficiary;
- The failure to explain the details of wealth held in the trust might hurt feelings of the trust beneficiary and could lead to litigation disputes in later years; and
- Even when "kept in the dark" by a quiet trust, an adult beneficiary usually has an inherent sense of his or her family's wealth.

A quiet trust can frustrate its trustee for several reasons. First, the statute of limitations to prevent the beneficiary's claims against the trustee for breach of trust will not start to 'run' if the beneficiary is uninformed of the trust or its administration. Second, on occasion the trustee will want to engage the trust beneficiary in a 'non-judicial settlement agreement' [which is authorized under the Michigan Trust Code] to alter the trust's administration; that flexible remedy, without having to go to the probate court asking permission, is unavailable if the beneficiary cannot sign the agreement because the beneficiary does not even know the trust exists. Third, if the trustee needs to decant the trust assets to a new trust to address tax and property law problems, yet another remedy under the Michigan Trust Code, the beneficiary cannot consent to the trustee's decanting when the trust beneficiary does not know about the trust. Finally, keeping the beneficiary informed promotes better

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Are Quiet Trusts Coming to Michigan?, continued

"A trustee with common sense knows that when you deliberately keep someone 'in the dark,' the normal assumption is that someone is hiding something and is up to no good."

trustee-beneficiary relationships, which reduces the likelihood that a beneficiary will complain about the trustee by filing a probate court petition. A trustee with common sense knows that when you deliberately keep someone 'in the dark,' the normal assumption is that someone is hiding something and is up to no good.

One solution that some states with quiet trusts have adopted to address many of the negatives associated with a quiet trust is to name a designated representative to 'stand in the shoes' of the trust beneficiary, who will receive disclosures from and hold the trustee accountable. The designated representative can represent and bind the beneficiary who they represent for purposes of receiving notices, accountings and the type of information that is required for a non-judicial settlement agreement or consent to a trust decanting. This option of using a designated representative provides the benefit of disclosure by the trustee while fulfilling the trust creator's goal to keep information about the trust and its finances away from the beneficiary. One unanswered question is whether a designated representative who receives communications from the trustee on behalf of the trust beneficiary serves in a fiduciary capacity.

It is too soon to say if Michigan will sometime soon permit quiet trusts. If the Michigan Trust Code is amended to authorize their use, serious thought needs to go into whether an existing trust should be modified or amended to add that as a feature, or if new trusts that are created will embrace the quiet trust concept. There are plenty of reasons both for, and against, a quiet trust.

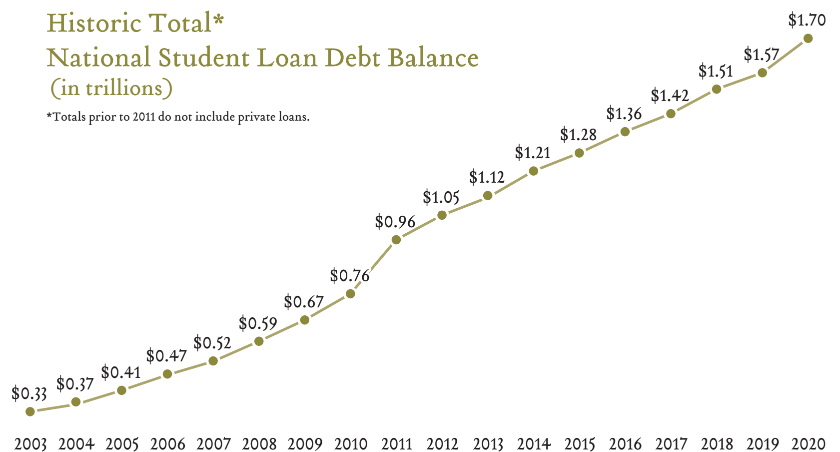
Evolution Of Education Debt

Allison L. Birmingham, CWS®, CCFS™
Senior Wealth Management Advisor

The facts are astounding. The figure now exceeds 43 million student borrowers, who are in debt by an average of $39,351 each. In an effort to attain a bachelor's degree, the average public university student borrows at least $30,000. And now, the largest it has ever been, the outstanding Federal Loan Portfolio of $1.56 trillion constitutes the majority of the outstanding $1.70 trillion national student loan debt. Unfortunately… these figures grow by the day.

Alarming facts and an eye on the labor force have ultimately motivated the Federal Government to act swiftly toward a resolution in reduction of student debt, beginning with the CARES Act of 2020. In March 2020, the Trump administration announced a student loan repayment freeze which, after many extensions, will finally terminate January 2022 with payments resuming February 1, 2022. The Act placed a 0% interest rate on all outstanding federal loans owned by the Department of Education. Some borrowers found this as an advantageous way to compound long-term savings – if their income was unchanged and expenses were

constant - by continuation of monthly payments, saving significantly on lifetime interest. Alternatively, relief was also given to those who had previously defaulted on their student loan – billing statements and collection calls were entirely suspended – granting those in financial distress a second chance.



Making recent waves, the US Department of Education announced it will cancel $5.8 billion in student debt for more than 320,000 borrowers. The debt forgiveness, however, will be allocated only toward borrowers with total and permanent disability. Information from the Social Security database will be used to identify these individuals, who will see relief beginning this September.

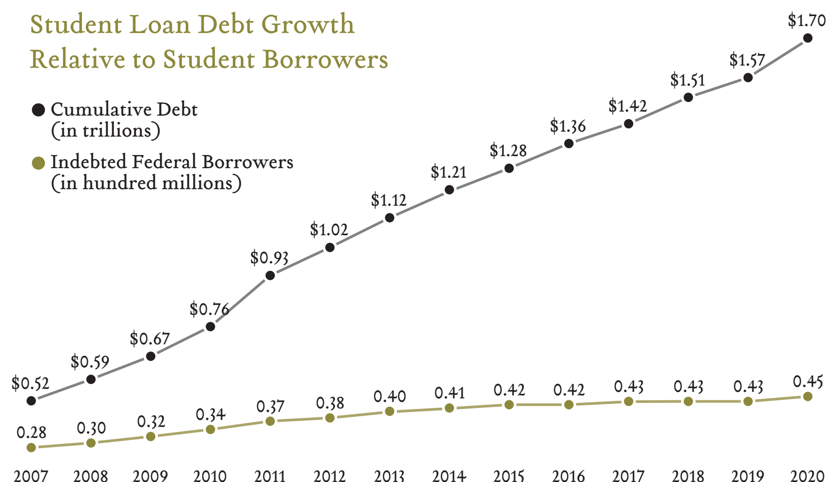
Most recently, the Education Department canceled debt for thousands of students who attended for-profit schools, or institutions of higher education which are owned and operated by private, profit-seeking businesses. Controversial action by the Department of Education on many levels, but nonetheless action was taken.

Although these actions seem like very small chips off a large block, it is clear the Education Department is showing interest in the issue and has a willingness to act, beginning with those borrowers who are simply unable to apply their degree in the labor force. Significant pressure remains on the current administration to go even further. One notion is to cancel $50,000 per borrower in student debt for all. This could possibly take effect through an Executive Order.

> "... more than 35 million of the roughly 43 million with federal student loans would qualify for student debt relief under the CARES Act of 2020."

Student borrowers still facing hardships as a result of COVID-19 should review their budget to ensure liquidity is available to make payments. If not, there are other options:

- Switching the loan to an income-based repayment plan in an effort to potentially reduce monthly payments.
- Refinance the student loan into a product with a lower interest rate (current all-time lows). Be careful not to act on this option too quickly. If the refinance brings your loan into a private student loan, eligibility for any Federal benefits would be eliminated.



Evolution Of Education Debt, continued

The heat remains on this growing topic and recent actions have confirmed the Department of Education and current administration are both willing to compromise. By just how much is yet to be seen, but don't ruin your credit in the meantime: make the on-time monthly payments or contact the loan provider directly with a request for deferment or loan extension, if needed.

Bradley S. LaTour, J.D., CTFA
Vice President, Senior Trust

Don't Let That Unused Estate Tax Exemption Go to Waste

The basic federal estate tax exclusion amount (often referred to as the estate exemption) is the amount a person can pass to their heirs tax-free through lifetime gifting or at death. Currently, the exclusion is $11.7 million per person, which means a married couple can pass a combined $23.4 million to their heirs without any estate tax. Sounds pretty good, right?

With such a high exclusion amount, many large estates are no longer required to file a federal estate tax return (or Form 706). However, there is a good reason to consider doing so for estates that exceed $3.5 million – to preserve a deceased spouse's unused exemption amount for the surviving spouse's later use.

SPOUSAL PORTABILITY

Since 2010, portability of the federal estate tax exclusion between spouses has become permanent, which means a surviving spouse may take advantage of any unused exemption from a deceased spouse (known as the deceased spousal unused exemption [DSUE] amount). Portability does not happen automatically, however, and may catch a surviving spouse by surprise at their later death or as they continue to make taxable gifts during their lifetime.

In order to elect portability of the DSUE amount for the benefit of the surviving spouse, the estate's representative must file an estate tax return and the return must be filed timely. The due date of the estate tax return, if the estate size requires it, is nine months after the decedent's date of death, however, the estate's representative may request an extension of time to file the return for up to six months. If a Form 706 is filed for the sole purpose to elect portability, it can be filed anytime prior to the second anniversary of the deceased spouse's date of death.

Another benefit to electing portability of the DSUE amount is that the unused amount is applied first to future taxable gifts made by the surviving

spouse. This will allow as much as possible to the survivor's heirs with no estate tax. Let's take a look at a typical estate to see how electing portability might be beneficial.

EXAMPLE ONE

Conrad and Gertrude have a combined estate of $10 million and their assets are split evenly between them (or $5 million each). Conrad dies in 2021 and all his assets pass to Gertrude. His exemption is $11.7 million, so no Form 706 is required, and there is no estate tax due at his death since his estate relied on the unlimited marital deduction. If Gertrude dies in 2024, three years later, she is able to pass her entire estate ($10 million, plus any assumed modest growth) without estate tax by applying her $11.7 million exemption (although her amount will be slightly higher in 2024 due to annual inflation adjustments).

WHY FILE A RETURN?

One might conclude that there is no need for either Conrad's estate to file a Form 706 or for it to elect the portability of Gertrude's husband's unused exemption amount. There was no estate tax due at Conrad's death and none due at Gertrude's death. Why should a Form 706 be filed if there is no tax, especially if the cost to prepare such a return could reach $6,000 or more?

There are several proposals currently being discussed in Washington, D.C. which would reduce the lifetime exemption, some to as low as $3.5 million per person. Even if Congress fails to act on any of these tax proposals (when has that ever happened, right?) then the current law sunsets at the end of 2025 and the lifetime exemption will automatically drop to around $5.5 million for estates beginning in 2026. In other words, the exemption is going to decrease, even if Congress does nothing. The only questions are when and by how much?

If the DSUE amount is not claimed on a timely filed Form 706, it is permanently lost to the surviving spouse. If there is no estate tax, there will be no issue. With a decreased exemption amount, however, many estates could find themselves subjected to estate taxes that they might otherwise not have paid had portability been elected.

Let's examine how a decrease might affect the previous example.

EXAMPLE TWO

At Conrad's death in 2021, there was no estate tax due and he passed all his assets to his wife, Gertrude. No election of portability of Conrad's DSUE was made because the lifetime exemption was so high, there appeared to be no need. If the lifetime exemption at Gertrude's death in 2024 has conservatively decreased to, say, $5 million by act of Congress, her estate of $10 million is going to face significant estate taxes. Gertrude can exempt $5 million with her own lifetime exemption, but the remaining $5 million will be subjected to a 40%

"... portability of the federal estate tax exclusion between spouses has become permanent, which means a surviving spouse may take advantage of any unused exemption from a deceased spouse."

Don't Let That Unused Estate Tax Exemption Go to Waste, continued

estate tax rate. That's two million dollars that Gertrude's heirs will pay because portability was not elected at Conrad's death!

By filing a Form 706 for Conrad's estate and electing portability of his unused exemption amount, Gertrude would have been able to shelter her entire $10 million estate from estate taxes.

"Portability does not happen automatically, however, and may catch a surviving spouse by surprise..."

CONCLUSION: ELECT THE PORTABILITY

Even if a spouse's estate does not require an estate tax return because the size of the decedent's estate is well below the filing requirement, there is a justifiable reason to file a return anyway. The only way to elect portability of a deceased spouse's unused exemption amount is by timely filing a Form 706. Considering the fact that the current exemption of $11.7 million will decrease in 2026, if not sooner, preserving the deceased spouse's remaining tax exemption can provide significant estate tax savings for the surviving spouse's estate.

Back-Door and Mega Back-Door Roth Reminders

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Several articles within *Perspectives* have been written about Roth planning techniques. Taking advantage of Roth contribution strategies remains a good financial planning strategy as individuals consider higher income taxes that they may face in their retirement years. As a result, more attention than ever is being given to Roth IRAs, Roth 401(k)s, Roth conversions, as well as 'back-door' Roth IRA conversions, and even 'mega back-door' Roth 401(k) contributions using after-tax contributions.

For those less aware of this topic, Roth contributions have the opposite tax treatment of the original pre-tax IRA/401(k) contributions. More specifically, investors pay income tax at the time of the Roth contribution/conversion, but then do not pay any taxes at the time of qualified Roth withdrawals in the subsequent years. This means all investment gains within Roth accounts can be withdrawn without capital gains or income tax implications, which is quite attractive for most people.

"Those familiar with the Roth world realize there are many nuances to consider with the advanced Roth planning concepts."

Those more familiar with the Roth world realize there are many nuances to consider with the advanced Roth planning concepts, especially for back-door and mega back-door Roth conversions. The back-door Roth is accomplished by an individual making a nondeductible contribution to a traditional IRA or 401(k). The IRA/401(k) owner then promptly converts those contributed dollars from the traditional IRA/401(k) to a Roth IRA/401(k) with virtually

no income tax consequences upon conversion. That said, there are some important conditions to consider before initiating these strategies.

Before electing a Roth IRA conversion, most will want to make sure pre-tax IRA contributions do not blend in with post-tax IRA contributions, otherwise the IRS's pro rata rule will be invoked. This is commonly referred to as the "cream-in-the-coffee rule" and it can trigger potentially unwanted taxes upon a conversion. Once after-tax funds (the cream) are combined with the pre-tax contributions (the coffee) from all of the owner's aggregated IRAs, every distribution from any one of the owner's IRAs will include some cream (tax-free) and coffee (taxable). Pro rata calculations are assessed based on IRA balances at the end of each calendar year, and are applied across all IRAs, even if only after-tax contributions are made to one traditional IRA and all pre-tax contributions are made to another traditional IRA. For those caught in this pro rata rule trap, rolling their pre-tax contribution amounts from the traditional IRA's to a 401(k) plan can help mitigate the problem. Since 401(k) accounts are not aggregated with IRA's, they can be ignored when applying the pro rata rules. Fortunately, most 401(k) plans accept IRA rollovers, making this a helpful tool to avoid unwanted tax bills.

Mega back-door Roth 401(k) conversions are very compelling at first sight, but several conditions need to be met prior to implementation. For starters, the employer sponsored plan has to allow after-tax contributions and permit in-service distributions or in-plan Roth conversions. None of these features are generally considered default Plan elections, but they can be taken care of with plan document amendments by a willing employer.

Perhaps the larger issue for smaller employers comes with the ACP Non-Discrimination testing. All 401(k) plans must satisfy the IRS's nondiscrimination testing rules, to ensure that the qualified plan does not favor highly compensated employees (HCE's) at the expense of non-highly compensated employees (NHCE's). Put simply, the HCE group is not allowed to receive a significantly higher percentage of their pay as retirement plan contributions than the NHCE's. Mega back-door Roth contributions can cause testing failures for small companies pretty quickly, which is essentially negates the ability to pursue the strategy further.

Although the pro rata and ACP testing rules can create issues, the planning techniques are still worth consideration for many individuals and employers alike. With the promise of much higher income taxes in the future under the Biden administration's recent income tax proposals, the opportunity to take tax-free distributions from a Roth IRA in retirement is something everyone with earned income should consider. How much a person can contribute into the Roth bucket year to year can vary based on several factors, including those described above, but Greenleaf Trust is available to help clients navigate the particulars of these advanced planning strategies at any time.

"With the promise of much higher income taxes in the future... the opportunity to take tax-free distributions from a Roth IRA in retirement is something everyone with earned income should consider."

Stock Market Pulse

Index	8/31/21	Total Return Since 12/31/2020
S&P 1500	1,032.86	21.54%
Dow Jones Industrials	35,360.73	17.04%
NASDAQ	15,259.24	18.94%
S&P 500	4,522.68	21.57%
S&P 400	2,753.16	20.30%
S&P 600	1,366.73	23.03%
NYSE Composite	16,806.44	17.36%
Dow Jones Utilities	934.30	10.62%
Barclays Aggregate Bond	2,375.43	-0.69%

P/E Multiples	8/31/21
S&P 1500	26.6x
Dow Jones Industrials	21.4x
NASDAQ	130.4x
S&P 500	27.1x
S&P 400	22.1x
S&P 600	21.8x

Key Rates

Fed Funds Rate	0.00% to 0.25%
Tbill 90 Days	0.03%
T Bond 30 Yr	1.93%
Prime Rate	3.25%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	1,032.86	26.6x	1.30%
S&P 500	4,522.68	27.1x	1.30%
Dow Jones Industrials	35,360.73	21.4x	1.73%
Dow Jones Utilities	934.30	18.2x	3.35%

Spread Between 30 Year Government Yields and Market Dividend Yields: 0.63%

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