Minimizing Estate Taxes in Advance of Anticipated Election-Related Estate Tax Changes

An Estate Tax Minimization Planning Webinar
Presented By:

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Q&A:

Deborah Howe, Esq.
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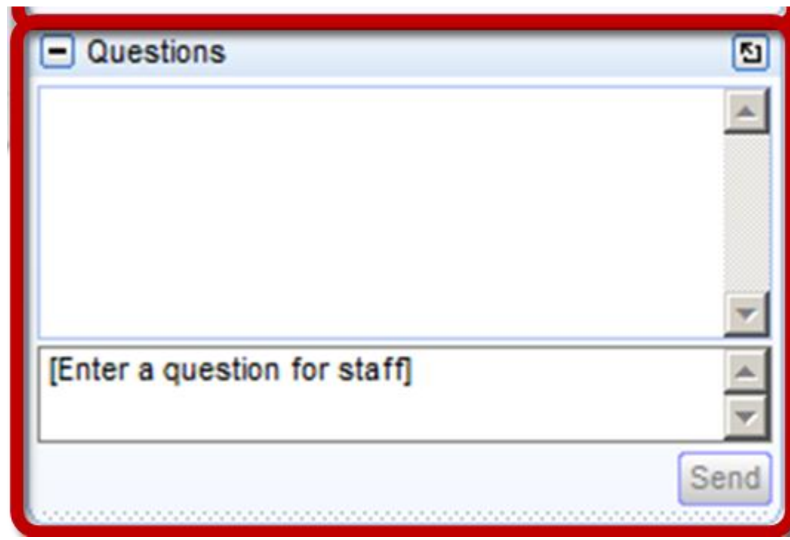
Please submit your questions via the Questions Box on the Control Panel.

Deborah Howe will host a Q&A session at the end of the webinar.



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Minimizing Estate Taxes in Advance of Anticipated Election-Relation Estate Tax Changes

Agenda

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Introduction: Estate Tax Framework

"How do I cut Uncle Sam out of my Will (or at least leave him the minimum possible)?"

Estate and Gift Tax Changes Under Biden Proposed Tax Plan

- Acceleration of the sunset of the Tax Cuts and Jobs Act, reducing the unified federal estate, gift & GST tax exemption by approximately 50% as of January 1, 2021 rather than January 1, 2026 under current law.

- Elimination of step-up in basis of assets at death, significantly increasing the tax bill on inherited assets.

- The above proposals make pre-election planning vitally important for individuals with highly appreciating, low-basis assets because:

  - The unified federal exemption is currently $11.58M for each individual or decedent for 2020 and $23.16M for each married couple.

  - In the event of a Democratic sweep in November, these exemptions may be reduced as of January 1, 2021, resulting in an exemption of approximately $5.8M per person or $11.6M per married couple.

  - In addition the unified exemptions may be further reduced or decoupled.

  - Significant gifts can currently be made using the $11.58/$23.16 exemption amounts, moving appreciation on the gifted assets outside of the taxable estate.

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Current Federal Estate Tax Framework

- Key provisions:
  - $11,580,000 per person/$23,160,000 per married couple for 2020.
    - These are the 2020 inflation-adjusted amounts to the $10M exemptions for estate, gift and GST tax.
  - Without further congressional action, law set to sunset after December 31, 2025 reducing above exemptions by 50%.
    - Estimated 2026 exemptions: $6.59M per person/$13.18M
  - Top tax rate 40%
  - Unused estate tax exemption of a deceased spouse (DSUE) is portable to the surviving spouse's estate.
  - Unused GST tax exemption of a deceased spouse is not portable to the surviving spouse's estate.
  - All inherited assets are marked to market as of date of death; this is referred to as the step-up in basis rule.

Current Federal Estate Tax Framework

- Federal estate tax is assessed on the value of assets included in the gross estate that are owned, directly or indirectly, by the decedent.
- Taxable assets at death include the date of death value of the home, closely-held business, life insurance death benefit, retirement plan balance, and other assets.
- Everyone can transfer up to their remaining estate tax exemption amount to their loved ones, outright or in trust, free of estate tax at death. (The exemption amount is reduced by certain gifts made during life.)
- Estate tax can be deferred until the death of the surviving spouse, via devises either outright or in qualifying trusts.
- With proper planning the federal and state exemption amounts can be fully utilized in the estate of both spouses.

June and Ward Cleaver – Current Assets
Total Estate of $25M

Asset:	June:	Ward:	Joint:
Residence			$3,500,000
Bank Accounts	$2,000,000	$2,000,000	$1,000,000
Investment Accounts	$2,000,000	$5,000,000	
Life Insurance	$1,500,000	$1,500,000	
Closely-Held Business		$5,000,000	
Retirement Accounts	$1,000,000	$500,000	

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Estate Tax Projections for June and Ward Cleaver

Assumes June dies first with fully funded estate plan in place.

Scenario	Massachusetts	Federal	Total Estate Taxes*
Deaths in 2020	$3,306,800	$0	$3,306,800
Deaths After Sunset of TCJA	$3,306,800	$3,653,290	$6,960,100

**Note:* No estate taxes due until Ward's second death.

Theodore and Wally's Inheritance:

Scenario	Estate Taxes	Net Estate	Each Son's Share
Deaths in 2020	$3,306,800	$21,693,200	$10,846,600
Deaths After Sunset of TCJA	$6,960,100	$18,039,900	$9,019,950

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The Impact of the Step-Up in Basis

Theodore and Wally sell the family business immediately after their parents' deaths.

Business sold immediately with step-up in basis (current law):

Ward's Basis in Business	$2,500,000
Value at Ward's Death	$5,000,000
Capital Gain with Step-Up	$0
Capital Gains Tax Rate*	20%
Capital Gains Tax Due	$0

Business sold immediately with carryover basis (Biden proposal):

Ward's Basis in Business	$2,500,000
Value at Ward's Death	$5,000,000
Capital Gain with No Step-Up	$2,500,000
Capital Gains Tax Rate*	39.6%
Capital Gains Tax Due	$990,000

*Net investment income tax (currently 3.8%) may also apply.

Minimizing Taxes and Maximizing Legacies: Pre-Sale/Pre-Appreciation Event Planning

Pre-Sale/Appreciation Event Planning – Individual Profile

- An individual whose business is appreciating in the near term and is interested in estate, gift and income tax minimization planning opportunities

Pre-Sale/Appreciation Event Planning – Benefits

- Making gifts to children/trusts for children at discounted values minimizes estate taxes by removing appreciation on the gifted assets from the taxable estate
- Family wealth can be transferred to trusts for children without jeopardizing non-tax family goals
- The business owner's retirement planning cashflow needs can be addressed simultaneously as part of a team-oriented planning effort
- If planning before a sale a Charitable Remainder Trust can defer income taxes due on sale for C corporations and partnerships

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Some Things to Consider When Gifting

- Do I need to keep this asset for any reason?
- Do I need this asset for retirement cash flow?
- How much of my gift and GST tax exemptions have I/we already used?
  - Premium gifts to your life insurance trust must be taken into account
- Which assets should I consider gifting?
  - Target high basis assets with high appreciation potential for gifts
- What is my cost basis in the assets being gifted?
  - The recipient will receive your cost basis in the assets
- A gift saves estate taxes on the asset's appreciation post-gift, not on the gift itself

Some Things to Consider When Gifting

- Do I want to give up control of this asset?
- Do I want my children to receive the gifted asset directly?
  - Is the child old enough to handle the gift wisely?
  - Am I confident that a child’s marriage will not end in divorce?
- Would it be advisable to make the gift into a trust instead?
  - Trustee control
  - Creditor protection
  - Benefit grandchildren in addition to children
- Biden’s tax plan calls for raising the capital gains tax rate to a top rate of 39.6%.
  - Consider selling the asset before the end of this year to take advantage of the lower capital gains rate and offset those gains by selling other assets that have built-in losses.

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Gifts of Marketable Securities and Real Estate

- Is the stock being gifted publicly or privately held?
- If an ownership interest in a privately held corporation, Limited Liability Company or partnership is being gifted be sure to review the governance documents for management and control provisions that affect the gift tax valuation:
  - Articles of Organization
  - Operating Agreement
  - Partnership Agreement
- Consider issues associated with gifting stock in a closely-held business when there is no time to obtain an appraisal before the end of the year. Consider using a "defined value gift".
- Real estate has its own valuation issues. How is the real estate owned? Outright, in a trust? In an LLC or a combination thereof? These structuring issues impact the gift tax appraisals.

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Valuation Discounts

Valuation Discounts – Individual Profile

- An individual who is in the highest marginal (40%) estate tax bracket, and who owns stock, a partnership interest, or real estate that is expected to appreciate substantially in the near term, and who is interested in minimizing estate, gift and income taxes

Valuation Discounts – Benefits

- Discounts allow partial interests in property to be gifted to the next generation at a value that is 20% to 40% less than the interest's proportionate share of the enterprise's fair market value
- Discounts create pre-sale and pre-I.P.O. estate planning opportunities
- Discounts can accelerate a gifting program designed to implement a business succession plan

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Valuation Discounts

Discounts Available For:

- *Lack of Marketability:* Takes into account that the interest is in a closely-held business and that there is no ready market for the stock
- *Minority Interest:* Takes into account that the interest being transferred by gift is a non-controlling interest. The IRS does not currently aggregate family interests for this purpose
- *Built-In Capital Gains Tax:* Takes into account the unrealized appreciation in value that tax would have to be paid on if the business were sold
- *Blockage:* For publicly traded stock, takes into account that the per share value of the stock might decline if a significant shareholder sold a large block of stock
- Qualified Business Appraiser (per regulations) must value interest being transferred to trigger three year gift tax statute of limitations

Grantor Retained Annuity Trust (GRAT)

GRAT – Individual Profile

- An individual who owns stock or other property that either is expected to appreciate at a rate in excess of the Section 7520 rate (changes monthly – historically, the rate has been around 5% – 8%; in recent years it has been much lower; 2.0% for January 2020), has strong cash flow, or is pre-IPO

GRAT – Benefits

- Allows the appreciation in the property's value that is projected to exceed the Section 7520 rate to be transferred to children at a minimal gift tax cost
- Annuity is retained for a term of years
- Children receive property remaining in trust at the end of the trust term free of additional gift or estate tax payments

Grantor Retained Annuity Trust (GRAT)

Parent
Age 50

Company stock proportionately valued at $5 Million; discounted for minority interest and lack of marketability by 40% to $3 Million for gift tax purposes

Grantor Retained Annuity Trust
3 Year Term

$1,118,193 Annual Annuity*

(Estimated total payments received over term of trust: $3,180,149)

Remainder after 3 Years***

Children or
Trust for Children
$4,469,694
(undiscounted)

***Assumes 20% rate of return over 3 year trust term

Taxable Gift

Property Transferred	**$3,000,000**
Retained Annuity	**($2,999,999)**
Taxable Gift*	**$ 0****

*Assumes Sec. 7520 rate is 2.8%

Projected Estate Tax Savings at 35%: $1,564,393

**Current law allows gift to be zeroed-out resulting in no taxable gift.

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Generation-Skipping Transfer Trust

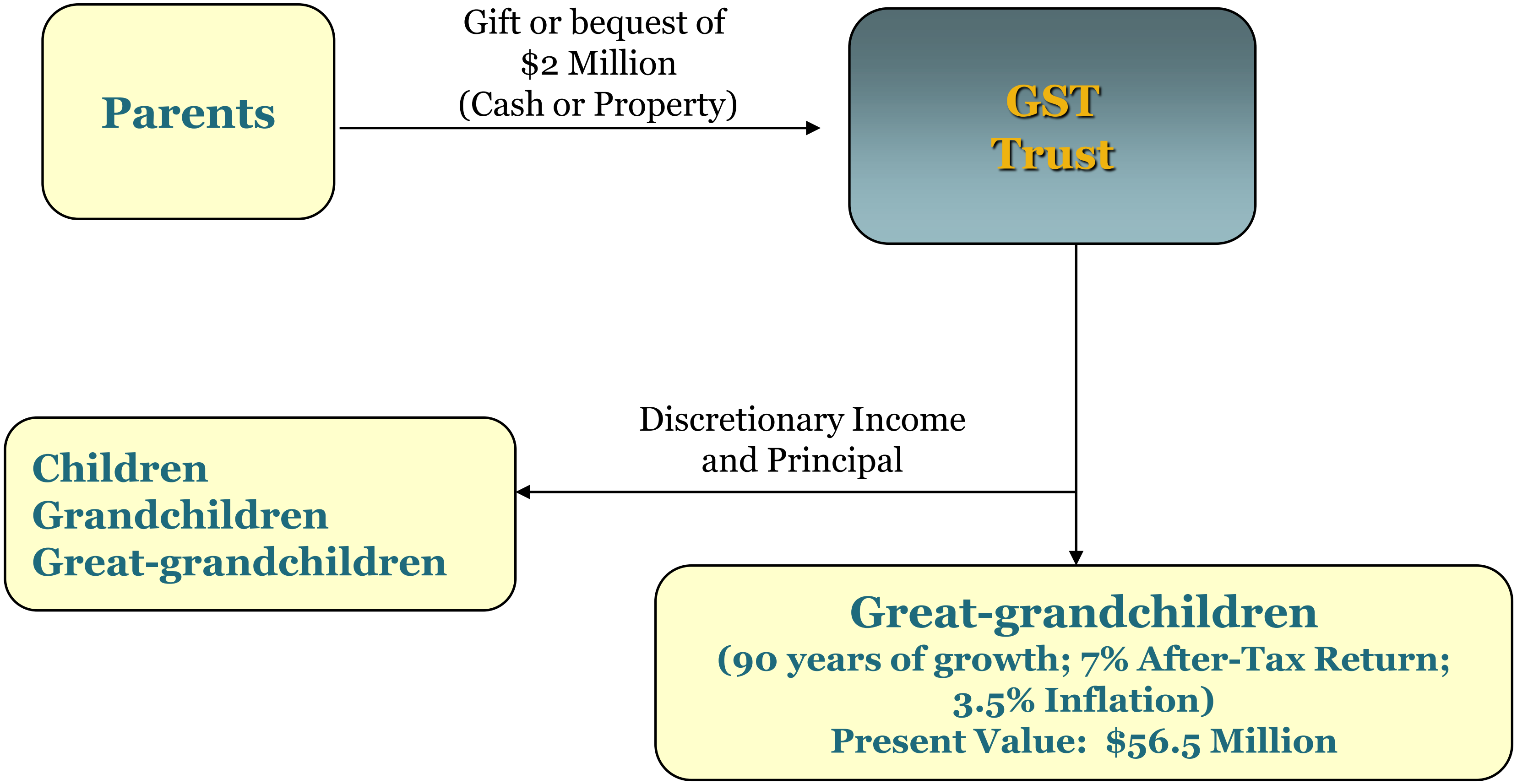
Generation Skipping Trust – Individual Profile

- An individual who has substantial assets that are expected to appreciate and wishes to make gifts or bequests to grandchildren and subsequent generations

Generation Skipping Trust – Benefits

- Vehicle allows for the transfer of appreciation to future generations at virtually no gift, estate or generation- skipping transfer tax cost
- Donor avoids paying estate tax on transferred assets
- Donor’s children may receive income and principal from the trust at the trustee’s discretion, but undistributed trust funds are kept out of reach of children’s creditors and out of the children’s estates
- Grandchildren and subsequent generations receive property remaining in trust at the end of the trust term

Generation-Skipping Transfer Trust



Value at end of joint life expectancies (year 32)*: $17.4 Million
Approximate estate tax savings: $6 Million

***Donor age 60 and Spouse age 57; Joint life expectancy = 32 years**

Charitable Remainder Trust (CRT)

CRT – Individual Profile

- An individual who owns highly appreciated assets* and who wishes to diversify without incurring an immediate capital gains tax, while increasing cash flow and satisfying charitable intentions

CRT – Benefits

- Increase lifetime income
- Cost-effective way to satisfy charitable intentions
- Avoid paying current capital gains tax on sale of assets
- Receive current income tax deduction
- Avoid paying estate tax on transferred assets
- Can use life insurance to replace wealth

*S Corporation stock not an eligible asset for contribution

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Sale of $1M Low Basis Stock Without a Charitable Remainder Unitrust (CRUT)

Donor and Spouse

Sell $1M low basis stock → **Outright Sale**

Invest after-tax proceeds and receive 7% annual return for joint lives* (lifetime cash flow projection: $1.2 M)

$1,000,000	Sale Proceeds
($0)	Basis
$1,000,000	Taxable Gain
($ 200,000)	20% Tax
$ 800,000	Net Proceeds

IRS $200,000 Capital Gains Tax

Diversification without CRUT

<u>After-tax proceeds without a CRUT: $800,000</u>
First year income yield of 2% without CRUT: $16,000

To generate more liquidity stock will be sold and additional capital gains tax paid

*7% Annual Total Return is 2% income and 5% capital appreciation; Donor age 60 and Spouse age 57; Joint life expectancy = 32 years

Sale of $1Million Low Basis Stock With a Charitable Remainder Unitrust (CRUT)

Donor and Spouse*

$1M Low Basis Stock**

CRUT
Trustee Sells $1M Low Basis Stock
(Zero Tax Due)

6% of Trust Assets Paid Annually For Joint Lives (Lifetime Cash Flow Projection: $1.97M)

Tax Deduction: $100,200***

Projected Trust Assets Remaining at Death

$463,000 to Family's Favorite Charities

Diversification with a CRUT

<u>After-tax proceeds with CRUT: $1,000,000</u>
First year cash flow at 6% with CRUT: $60,000

Cash flow will increase annually if trust return > 6%
Trust payments are taxable income to donor
Income tax savings from gift: $33,066

* Assumes 6% Unitrust Payout; 7% Return in Trust; 33 % Tax bracket; Donor age 60 and Spouse age 57; joint life expectancy = 32 years
** S Corporation stock not an eligible asset for contribution
*** Assumes Section 7520 Rate = 3.6% (must use highest of current month or previous two months)

Biography: Deborah Pechet Quinan, Esq. LL.M.

Deborah Pechet Quinan is a shareholder of Ruberto, Israel & Weiner PC and Chair of the firm's Trust & Estates Group. Her practice is concentrated in the areas of estate planning, tax planning, and the administration of trusts and estates, with an emphasis on estate and business succession planning for individuals, closely-held business owners, entrepreneurs and corporate executives. Her practice includes estate planning for retirement assets, international estate planning and charitable giving. Deborah also coordinates closely with other advisors in assisting clients with their financial planning needs.

Previously, Deborah was a director in the Trusts & Estates department at Rackemann, Sawyer & Brewster, a Boston law firm.

Before that, Deborah was the National Director of Estate & Financial Planning Services at State Street Corporation in State Street Global Advisors' Private Asset Management division. In her role, Deborah was responsible for a department that provided integrated financial, estate and investment planning strategies to SSgA's individual investment management clients. She also advised clients with respect to sophisticated estate and charitable planning strategies.

Prior to joining SSgA in 1997, Deborah was the New England Area Director of Estate and Business Succession Planning for Ernst & Young and an Associate Director of the Ernst & Young Center for Family Wealth Planning. Prior to Ernst & Young, Deborah practiced law in the Estate Planning and Probate Department of the law firm Mirick, O'Connell, DeMallie & Lougee in Worcester, Massachusetts.

Deborah is a member of the American, Massachusetts, and Boston Bar Associations, the Boston Estate Planning Council and the Boston Probate and Estate Planning Forum. Deborah is a past Co-Chair of the Boston Bar Association's (BBA) Trusts & Estates Section and is also a past Co-Chair of the BBA's Estate Planning Committee. Deborah serves on the Boston Board of Advisors for the Entrepreneurship Institute. She served on the Boards of Trustees of The Essex County Community Foundation, Temple Ner Tamid, in Peabody, Massachusetts, and the Glen Urquhart School, in Beverly, Massachusetts. In addition, she was elected one of the top 100 lawyers in the country by *Worth* magazine in 2006 and 2008, one of the top ten lawyers in the Women's Business Journal 2005 Readers' Poll, and has been elected a Massachusetts Super Lawyer for many years. Deborah has achieved Martindale-Hubbell's AV rating.

Deborah is a frequent speaker on estate planning topics for both lay and professional audiences. For many years she has spoken for Massachusetts Continuing Legal Education panels and she served on MCLE's Estate Planning Curriculum Committee. She also served on the Topsfield Cultural Council and was a Board Member of the Masconomet Girls Soccer Boosters. Deborah has been quoted in *Bloomberg Wealth Manager* magazine*, The Wall Street Journal, Bloomberg Personal Finance* magazine, *Money* magazine, *American Banker*, and *The Boston Business Journal*.

Deborah graduated from Hamilton College with honors in Comparative Literature. She received her JD, cum laude, from Suffolk University Law School and her LL.M., in Taxation, from Boston University Law School. Deborah lives in Middleton, Massachusetts, with her husband Kevin, and their daughter Dana.

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Biography: Bill Friedler, Esq.

Bill Friedler is a Shareholder in the firm's Trusts & Estates Group. Bill has concentrated his practice in the areas of complex estate planning, probate and trust administration, planning for adults or children with special needs and disabilities, elder law and Medicaid planning. Bill represents his clients for their corporate estate planning needs and is knowledgeable about business succession planning.

Prior to RIW, Bill founded and served for 25 years as the Managing Partner of The Friedler Law Group, a boutique law firm specializing in Trusts & Estates. Most recently Bill served as Partner and Chair of the Trusts & Estates group at Conn Kavanaugh Rosenthal Peisch & Ford in Boston.

Bill has been a frequent speaker on both radio and television and has been quoted in a variety of publications over the years on topics in Estate Planning, Probate Administration, and Elder Law.

Bill has been chosen by New England Super Lawyers every year since 2009 to be designated as a Massachusetts "Super Lawyer" in his field as an Estate Planner. In 2019 he was also chosen by New England Super Lawyers to be designated as a Massachusetts "Super Lawyer" in the field of Elder Law. He has also been selected to be included in the 2015 through 2021 publication of "Best Lawyers In America" in the field of Elder Law.

Bill previously served as Chair of the Massachusetts Bar Association Taxation Section Council and President of Temple Beth Avodah in Newton. He currently serves as a member of the Professional Advisors Committee of the Brookline Community Foundation.

Bill graduated from Wesleyan University with honors. He received his JD from Suffolk University Law School and was the lead article editor of the Suffolk Transnational Law Review. He received his LL.M., in Taxation, from Boston University School of Law.

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Q&A:

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Thank You

For more information or questions related to topics discussed during the webinar, please reach out to:

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