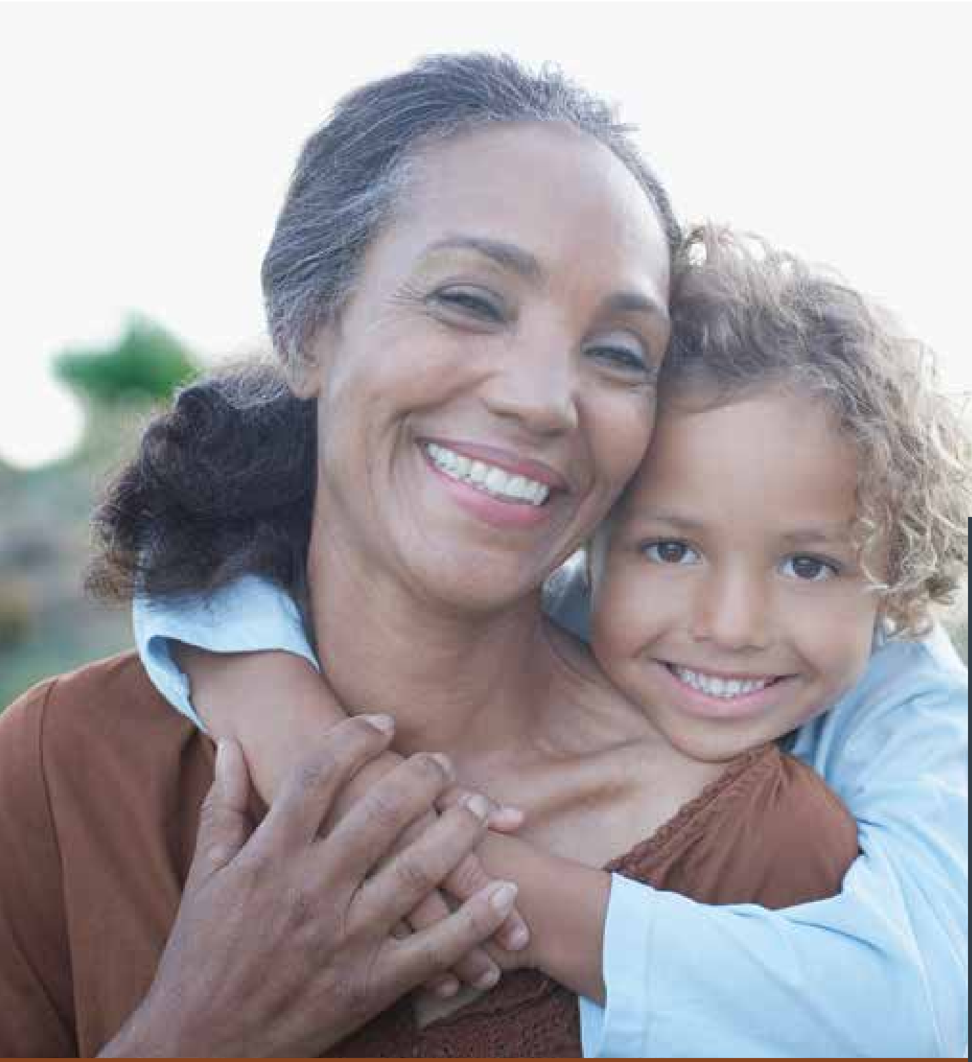
INSIGHT ON ESTATE PLANNING



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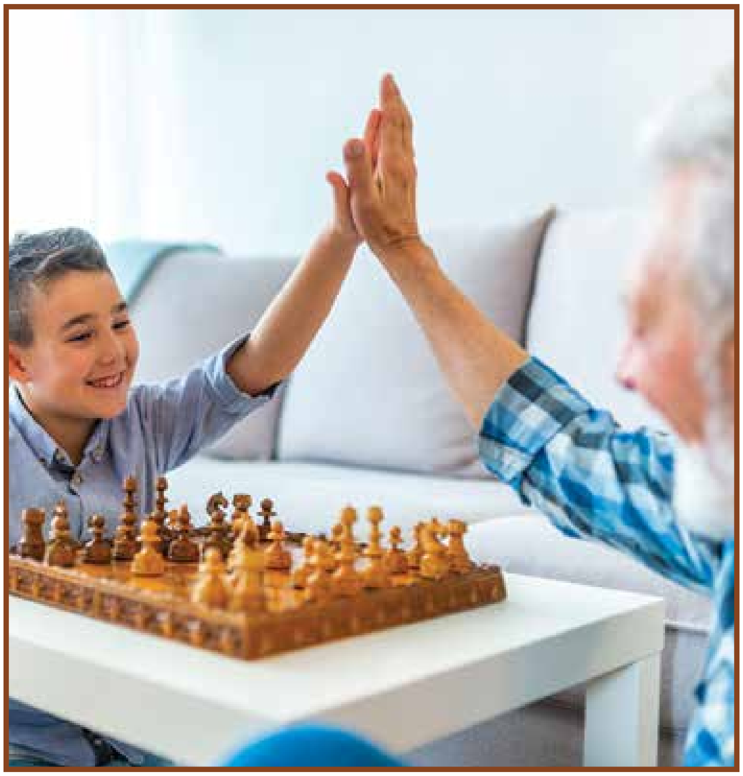
Beware of the generation-skipping transfer tax

Thanks to recent tax law changes, most families can avoid liability for federal estate and gift taxes. However, there's a lesser-known tax whammy that can hit wealthy individuals without warning: the generation-skipping transfer (GST) tax. As its name implies, the GST tax generally applies to transfers that "skip" a generation.



Nevertheless, with astute estate tax planning, including the use of a generous lifetime gift tax exemption, you may be able to sidestep any dire consequences under the GST tax, or at the least minimize its impact.

History of the GST tax

The genesis of the GST tax goes back to the 20th century. Normally, federal estate tax would be triggered after the owner of sizable assets passed away. Instead of leaving assets to their children, however, wealthy individuals often bypassed the next generation and bequeathed or gifted the property to their grandchildren, who were expected to end up with the bulk of the wealth anyway. This effectively eliminated one tax bite at the apple for Uncle Sam.

Accordingly, Congress enacted legislation to close this "tax loophole" in the form of the GST tax. Introduced in 1976, the GST tax applies to transfers to related individuals more than one generation away — such as grandchildren or great-grandchildren — and unrelated individuals more than 37½ years younger. All these designated beneficiaries are referred to as "skip persons."

Furthermore, taxpayers can't sidestep this potential tax pitfall simply by transferring assets to a trust, with descendants named as ultimate beneficiaries. For these purposes, all of the trust beneficiaries are treated as skip persons and even the trust can be a skip person in certain circumstances.

Be aware that the tax law provides a special exception concerning grandchildren whose parents have predeceased them. In this event, the grandchildren are effectively moved up the line in the place of their parents, so the transfers no longer are technically skipping a generation. But such transfers are still subject to regular federal estate tax.

Key components

Many of the rules relating to the GST tax mirror the rules applying to federal estate tax. For example, GST tax rates are currently the same as they are for regular estate tax liability. Under the last tax rate change, which went into effect in 2013, the top tax rate increased from 35% to 40%, where it remains today.

The GST tax exemption amount, indexed for inflation, mirrors the federal gift and estate tax exemption amount. The exemption amount has jumped dramatically since 2000, when it was $675,000. Under the latest legislation affecting these rules, the Tax Cuts and Jobs Act, the GST tax exemption was doubled along with the regular federal estate tax exemption, from $5 million to $10 million.

Many of the rules relating to the GST tax mirror the rules applying to federal estate tax.

As previously mentioned, the GST tax exemption is indexed for inflation. The amount for 2020 is $11.58 million. In other words, a married couple can effectively use a combined exemption of $23.16 million to shield assets from the GST tax.

Also, be mindful that you can benefit from another GST tax exemption for lifetime transfers that is aligned with the annual gift tax exclusion. Just like the annual gift tax exclusion, you can gift up to $15,000 per person, including a grandchild or other descendant, each year without triggering any GST tax liability. This exclusion is also indexed for inflation, but it remains the same in 2020 as it was in 2019.

GST tax strategies in action

If you find that you have generation-skipping transfer (GST) tax liability, there are steps you can take to minimize or eliminate the tax bite:

1. Maximize the use of the GST tax exemption. Even though lifetime transfers reduce the available tax shelter, the current $11.58 million exemption ($23.16 million for a married couple) should provide plenty of flexibility.

2. Use your annual exclusion. This can shelter from tax gifts of up to $15,000, above and beyond the lifetime exemption. Use this before tapping into your lifetime gift tax exemption. Keep in mind that, subject to certain restrictions, payments for tuition and medical expenses paid directly to the school or medical provider aren't considered gifts and, thus, wouldn't be subject to the GST tax.

3. Take advantage of the ability to use trusts when appropriate. Coordinate these strategies as part of your estate plan.

Be aware that gifts made to skip persons directly or through a trust are referred to as "direct skips." If any GST tax is paid rather than applying the lifetime exemption, the direct skip is turned into an "indirect skip."

Turn to the professionals

Clearly, the GST tax rules are complex, and only the highlights have been discussed. In addition, you may face state tax complications, since many jurisdictions have their own version of a GST tax. The bottom line is to seek the assistance of your estate planning advisor. •

To file or not to file?

A gift tax return doesn't always have to be filed

Now that fewer people are subject to federal gift taxes, because of a generous $11.58 million lifetime gift tax exemption for 2020, a question many are asking is: "Do I need to file a gift tax return?" The short answer is "no" if your wealth is well within the exemption amount. However, there are scenarios where it's necessary (and possibly advantageous) to file Form 709 — "United States Gift (and Generation-Skipping Transfer) Tax Return."

Nontaxable gifts

The federal gift tax regime begins with the assumption that all transfers of property by gift (including below-market sales or loans) are taxable, but there are exceptions. Nontaxable transfers that need not be reported on Form 709 include:

- Gifts of present interests (see below) within the annual exclusion amount (currently, $15,000 per donee),
- Direct payments of qualifying medical or educational expenses on behalf of an individual,
- Deductible charitable gifts,
- Gifts to one's U.S.-citizen spouse, either outright or to a trust that meets certain requirements, and
- Gifts to one's noncitizen spouse within a special annual exclusion amount (currently, $157,000).

If all your gifts for the year fall into these categories, no gift tax return is required. But gifts that don't meet these requirements are generally considered taxable — and must be reported on Form 709 — even if they're shielded from tax by the lifetime exemption.

Beware of pitfalls

If you make gifts during the year, consider whether you're required to file Form 709. And watch out for these common pitfalls:

Future interests. The $15,000 annual exclusion applies only to present interests, such as outright gifts. Gifts of future interests, such as transfers to a trust for a donee's benefit, aren't covered, so you're required to report them on Form 709 even if they're less than $15,000. Be aware, however, that it's possible for gifts in trust to meet the present interest requirement by giving beneficiaries Crummey withdrawal powers (the right to withdraw a contribution for a limited time after it's made).

Spousal gifts. As previously noted, gifts to a U.S.-citizen spouse need not be reported on Form 709. However, if you make a gift to a trust for your spouse's benefit, the trust must 1) provide that your spouse is entitled to all the trust's income for life, payable at least annually, 2) give your spouse a general power of appointment over its assets and 3) not be subject to any other person's power of appointment. Otherwise, the gift must be reported. And watch out for gifts to a noncitizen spouse: If they exceed the $157,000 annual exclusion, they must be reported whether they're outright gifts or gifts in trust.

Gift splitting. Spouses may elect to split a gift to a child or other donee, so that each spouse is deemed to have made one-half of the gift, even if one spouse wrote the check. This allows married couples to combine their annual

exclusions and give up to $30,000 to each donee. To make the election, the donor spouse must file Form 709, and the other spouse must sign a consent or, in some cases, file a separate gift tax return. Keep in mind that, once you make this election, you and your spouse must split *all* gifts to third parties during the year.

529 plans. If you make gifts to a 529 college savings plan, you have the option of bunching five years' worth of annual exclusions into the first year. So, for example, you can contribute $75,000 to the plan ($150,000 for married couples) and treat the gift as if it were made over the next five years for annual exclusion purposes. To take advantage of this benefit, you must file an election on Form 709.

When to file voluntarily

It may be a good idea to file a gift tax return, even if it's not required. For example, if you make annual exclusion gifts of difficult-to-value assets, such as interests in a closely held business, a gift tax return that meets "adequate disclosure" requirements will trigger the three-year limitations period for audits.

Suppose you transfer business interests valued at $10 million over a period of years, through a combination of tax-free gifts to your spouse and annual exclusion gifts to your children. If the IRS finds that the interests were worth $15 million, which exceeds the lifetime exemption amount, it can assess gift taxes plus penalties and interest. If you don't file regular gift tax returns, the IRS has unlimited time to challenge the values of your gifts.

Proceed with caution

Making gifts remains an excellent way to reduce the size of your estate and benefit your loved ones. If you've made gifts, contact your estate planning advisor to help determine if you need to file a gift tax return with the IRS. •

Letter of instructions

Make your thoughts crystal clear to your family

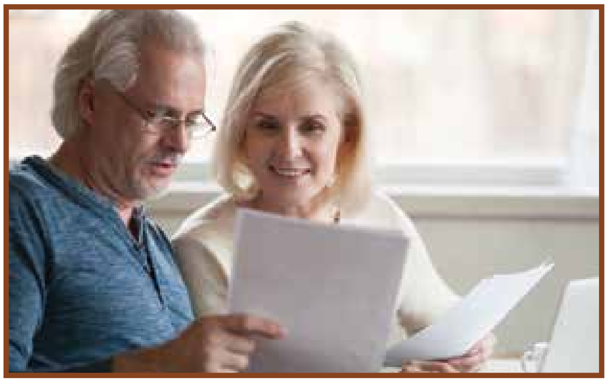
Generally, every estate plan requires a will, but this main attraction may be complemented by other documents, like a letter of instructions. The letter, unlike a valid will, isn't legally binding, but can be valuable to surviving family members.

If you haven't done so already, draft a letter of instructions and, most important, make sure that others know where and how to locate it.

The basic elements

Although the content can vary from person to person, one of the main purposes of a letter of instructions is to provide details on final wishes that haven't been covered in the will. Think of the letter as a way to fill in some of the "gaps" or resolve matters left open to interpretation.

For example, a letter of instructions may cover the music you want played during a wake or the nature of postings on social media accounts. In some cases, a letter might even list potential schools for your grandchildren to attend or the religious beliefs you hope they follow.



Furthermore, the letter can detail vital financial information that has been omitted or glossed over in the will. Typically, this will include an inventory of real estate holdings, investment accounts, bank accounts, retirement plan accounts and IRAs, life insurance policies, and other financial assets.

Along with the account numbers, list the locations of the documents, such as a safe deposit box or file cabinet. And don't forget to provide the contact information for your estate planning team. Typically, this will include your attorney, CPA, financial planner and life insurance agent. These professionals can assist your family during the aftermath.

In today's digital age, access to financial accounts is password protected. Therefore, you should provide the relevant passwords or at least point to where and how passwords can be recovered. Because this information is sensitive, make sure that outsiders can't access it.

Similarly, provide passwords to your email addresses and social media accounts. Instruct your family on how to notify friends and family of a passing.

Details to cover

There are no hard-and-fast rules for writing a letter of instructions. The basic elements are outlined above, but the choices are ultimately up to you. Remember that the letter isn't legally binding, so there are no obligations to include any particular item. Conversely, you can say pretty much whatever else you want to say.

Your letter can go into as much or as little detail as you like. However, you'll probably want to provide simplified guidelines for your loved ones to follow during an emotional time. Keep that in mind when you put your thoughts into writing.

Also, you don't have to write the letter in a single sitting. If you're experiencing writer's block, come back to it at another time. You may find it helpful to jot down notes when things occur to you and eventually summarize these thoughts in a final version. If you're still having difficulty, contact your estate planning advisor.

Not a static document

Completing the letter of instructions isn't the end of the story. You may have to revisit it for rewrites or edits you didn't accommodate before. For example, you could have neglected to specify certain accomplishments you want mentioned in an obituary.

In addition, it's likely that some of your personal information will change over time, such as bank account numbers and passwords. Update the letter when warranted. Think of it as an ongoing process.

Finally, make sure that the letter is secured in a safe place. Any printed version should accompany your will or be located somewhere else that is accessible to trusted family members. At the same time, you must be able to update the letter whenever you need to.

Gather your thoughts and get to work

A letter of instructions can't override a will, but it does provide clarity. Don't put off this task any longer. •

ESTATE PLANNING PITFALL

You fail to mention a close relative in your will

Typically, you arrange to leave most of your assets to various family members, including your spouse and children. These dispositions are spelled out in your will. But you don't have to do what's "expected" of you.

For example, you may have your reasons for "disinheriting" a family member. Perhaps you're estranged from the person or feel that he or she already has sufficient wealth. After all, it's your property to do with whatever you see fit. However, failing to even mention the relative in your will could lead to legal problems.

The exact nature of a potential dispute depends on the prevailing laws in your state. However, there are some general principles to observe. Specifically, a spouse or child may otherwise be entitled to a share of your assets, regardless of your intentions. Or a relative might claim that the omission is an unintended oversight or caused by undue influence from another party or a lack of competency.

This could result in a challenge to the will's validity and throw the entire family into chaos. Also, your assets may be frozen, helping no one, until the legal issues can be untangled.

The prudent approach is to clearly state that you're disinheriting the relative in your will and corroborate it in documents, such as a letter of instructions. (For more on a letter of instructions, see the article "Letter of instructions: Make your thoughts crystal clear to your family.") Of course, this doesn't guarantee that the disinherited family member won't challenge the will's validity, but it provides some legal support.

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Knowledgeable, **Responsive**, **Reliable**, **Diligent** and **Compassionate** are the words most often heard from our clients when they describe our firm. ***Knowledgeable*** because our team is intelligent and well-informed and has an understanding of this area of the law that comes with experience or education. ***Responsive*** because we are always quick to react to and answer our client's questions. ***Reliable*** because we are consistently good in our quality of work or performance and thus able to be trusted. ***Diligent*** because we work hard and are attentive and persistent in doing our job. ***Compassionate*** because we have a strong desire to help our clients.

Approximately half of our attorneys practice in the areas of tax, estate and trust planning and administration, asset protection and business exit planning. The rest of our attorneys focus on trust, estate, and guardianship litigation. By limiting our law practice to these areas, we actually can provide our clients with more value. Our combination of expertise means we can plan and protect our client's family and business wealth so that they can prosper.

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