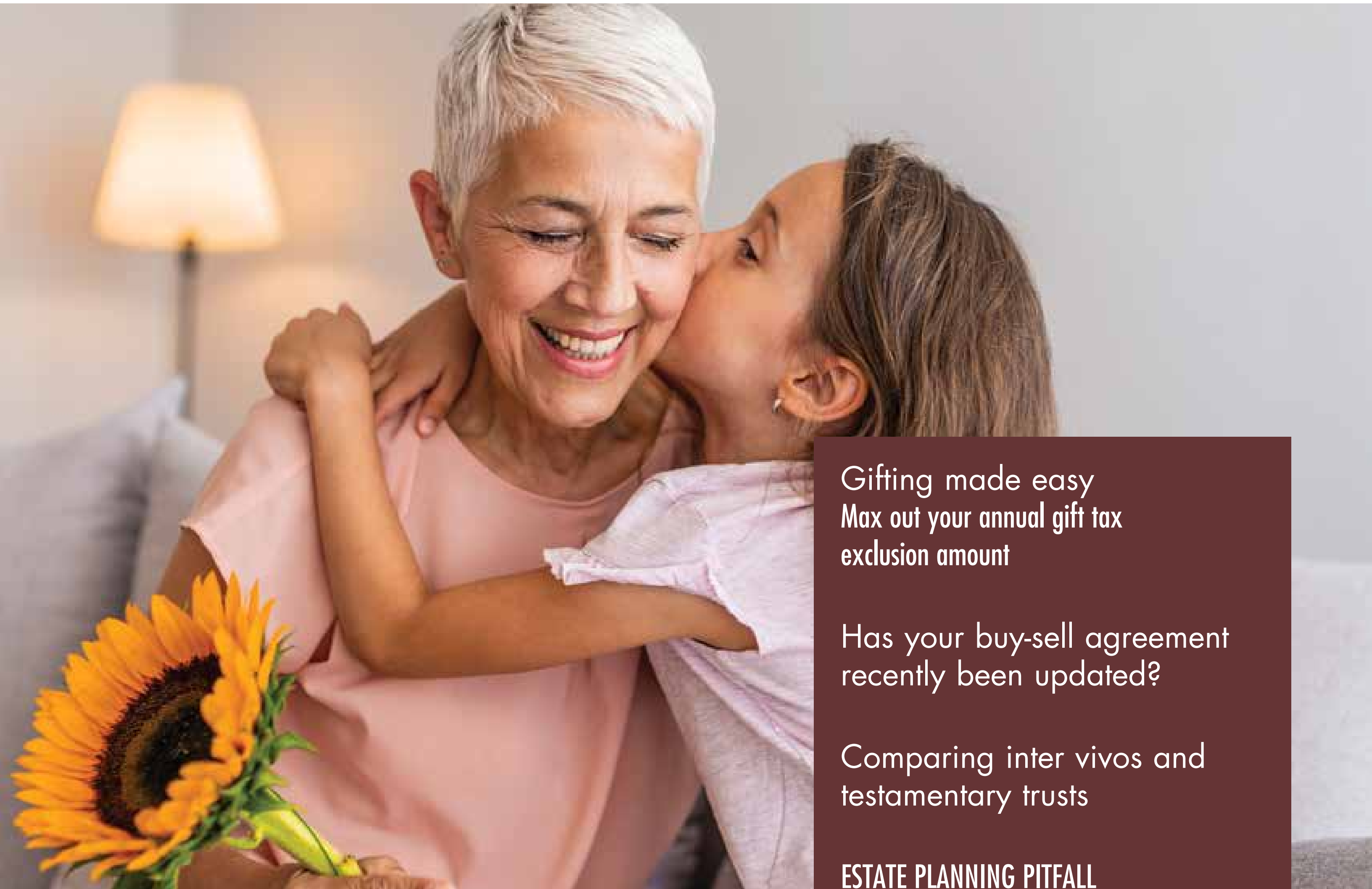
INSIGHT ON ESTATE PLANNING



Gifting made easy
Max out your annual gift tax exclusion amount

Has your buy-sell agreement recently been updated?

Comparing inter vivos and testamentary trusts

ESTATE PLANNING PITFALL
You haven't made funeral arrangements

FEBRUARY / MARCH 2023

LEGACY PROTECTION LAWYERS, LLP

100 - 2nd Avenue South, Suite 900 • St. Petersburg, Florida 33701
T: 727.471.5868 F: 727.498.5696

www.LegacyProtectionLawyers.com

Gifting made easy

Max out your annual gift tax exclusion amount

The annual gift tax exclusion amount has increased for the second straight year. The IRS raised the exclusion amount for 2023 to $17,000 per recipient, up from $16,000 per recipient in 2022. In the recent past, adjustments were more sporadic — often going several years before an increase.

By using the annual gift tax exclusion judiciously, you can transfer assets to your loved ones and reduce the size of your taxable estate without eroding your federal gift and estate tax exemption. Consider taking advantage of this higher amount if you have significant wealth you want to transfer to family members. Here are the answers to some basic gifting questions.

How does the annual exclusion work?

Generally, gift tax is due when you give cash or property to another person. However, the annual gift exclusion can be used to cover certain gifts made during the year. If you exceed the annual gift tax exclusion limit, the excess may be sheltered by the gift and estate tax exemption.

Note that the exclusion amount is adjusted for inflation, but only in increments of $1,000. Rising inflation in 2022 resulted in a bump-up to $17,000 per recipient in 2023. Thus, you can pass even more assets to beneficiaries without any tax consequences, especially if you take a systematic approach.

For instance, if you have three adult children and seven grandchildren, you may give each

U.S. Tax Court rules on deathbed gifts

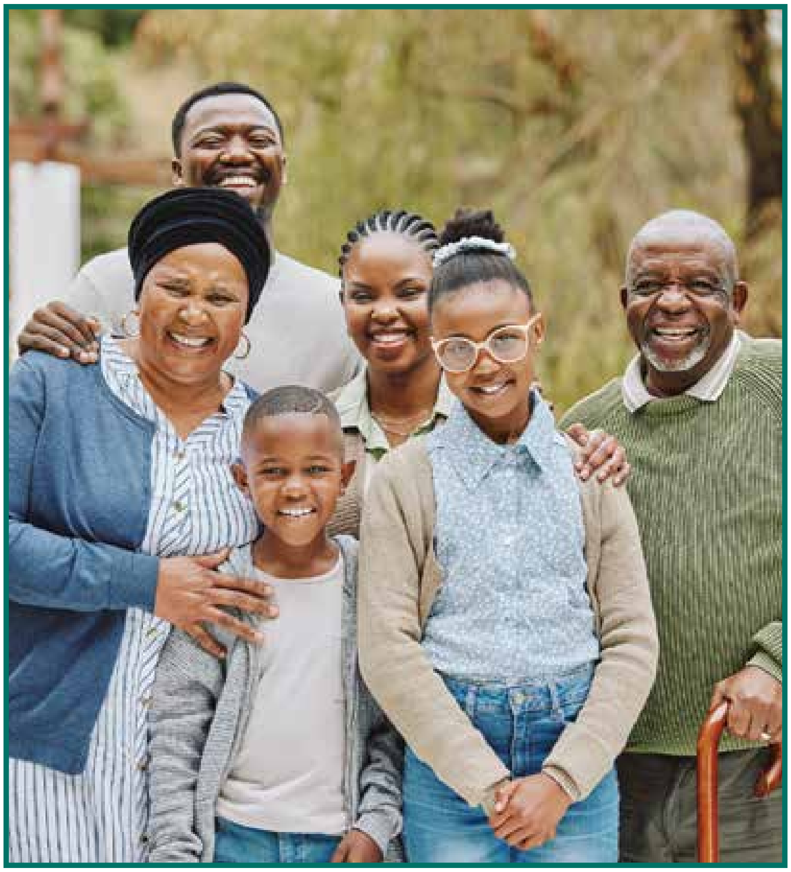
When is a gift complete? It may depend on prevailing local law. The issue often arises for "deathbed gifts" made by someone in failing health.

The U.S. Tax Court recently ruled on deathbed gifts. In this case, the deceased, a resident of Pennsylvania, authorized his son through a power of attorney to give gifts to family members in amounts not exceeding the annual gift tax exclusion. From 2007 through 2014, the son made annual gifts to his brothers and other family members.

In 2015, just five days before the father's death, the son gave eleven checks to other family members out of an investment account, totaling $464,000. Some recipients deposited the checks before the father's death, but others didn't. Only one check was paid by the investment account before the father's death.

Based on Pennsylvania law, the Tax Court said that the checks deposited before death are covered by the annual gift tax exclusion. However, any checks that weren't deposited in time must be included in the deceased's taxable estate. *Demuth, TC Memo 2022-72, 7/12/22.*

one the maximum $17,000 in 2023 for a total of $170,000. Then you can do the same in the following four years. Assuming the maximum exclusion remains at $17,000 per recipient, you can pass a total of $850,000 by using this technique. And, depending on the circumstances, you won't have to file a gift tax return.



Furthermore, the annual gift exclusion is available to each taxpayer. If you're married and your spouse consents to a "split gift," the exclusion amount is effectively doubled to $34,000 per recipient.

Want to make larger, tax-free gifts?

As previously mentioned, the gift and estate tax exemption can shelter gifts that are above the annual gift tax exclusion from taxation. Currently, the exemption effectively shelters $10 million from tax, indexed for inflation. The inflation-indexed amount of $12.06 million in 2022 has increased to $12.92 million in 2023. This amount is scheduled to revert to $5 million, plus inflation indexing, in 2026, unless Congress acts.

What gifts are tax-exempt?

Certain gifts are exempt from gift tax. This includes gifts that are:

- From one spouse to the other (unless the receiving spouse is not a U.S. citizen),
- To a qualified charitable organization,
- Made directly to a health care provider for medical reasons, or
- Made directly to an educational institution for a student's tuition.

Also, you may take advantage of a special tax break for gifts made to a Section 529 plan for a student beneficiary. Essentially, you can give the equivalent of five years' worth of gifts in just one year with no gift tax repercussions by "front-loading" the gifts. Note, however, that if you don't survive for enough time after the gift is made, a portion of the gift will become taxable. Suppose, for example, that Jane made a gift of $85,000 to the 529 plan of a grandchild earlier this year. So long as she lives until 2027, no portion of the gift will be taxable.

Do you have a gifting strategy?

The annual gift tax exclusion amount is a powerful tool in your estate planning toolbox. Using it can provide a simple solution for transferring wealth to other family members. Contact your estate planning advisor with questions regarding your overall gifting strategy. •

Has your buy-sell agreement recently been updated?

A buy-sell agreement should be a critical part of your estate plan if you have an interest in a business that's closely held or family owned. The agreement provides for the disposition of each owner's interest after a "triggering event," such as death, disability, divorce, termination of employment or withdrawal from the business.

A properly drafted buy-sell agreement can help address a variety of issues business owners and their families may face when a triggering event occurs. But if yours doesn't include the appropriate provisions, it may not do its job.

Revisit the valuation provision

It's particularly important to revisit the agreement's valuation provision — the mechanism for setting the purchase price for an owner's interest — to be sure that it reflects the current value of the business. There are a couple of reasons why now is an appropriate time to review your agreement.

First, the COVID-19 pandemic may have affected the value of your business, so it's a good idea to ensure that your buy-sell agreement will produce a fair price. Second, absent congressional action, the federal gift and estate tax exemption is scheduled to be halved beginning in 2026, so a carefully drafted buy-sell agreement may soon be even more important than before.

As you review your agreement, pay close attention to the valuation provision. Generally, a valuation provision follows one of these approaches when a triggering event occurs:

1. Formulas, such as book value or a multiple of earnings or revenues as of a specified date,
2. Negotiated price, or
3. Independent appraisal by one or more business valuation experts.

Independent appraisals almost always produce the most accurate valuations. Formulas tend to become less reliable over time as circumstances change and may lead to over- or underpayments if earnings have fluctuated substantially since the valuation date.

A negotiated price can be a good approach in theory, but expecting owners to reach an agreement under stressful, potentially adversarial conditions is asking a lot. One potential solution is to use a negotiated price but provide for an independent appraisal in the event the parties fail to agree on a price within a specified period.

Establish the business's value

Business valuation is both an art and a science. Because the process is subjective, to an extent, there can be some uncertainty over the value of a business for estate tax purposes. If the IRS later determines that your business was undervalued on the estate tax return, your heirs may face unexpected — and unpleasant — tax liabilities.

A carefully designed buy-sell agreement can, in some cases, establish the value of the business for estate tax purposes — even if it's below fair market value in the eyes of the IRS — helping to avoid these surprises.

Generally, to establish business value, a buy-sell agreement must:

- Be a bona fide business arrangement,
- Not be a "testamentary device" designed to transfer the business to family members or other heirs at a discounted value,
- Have terms that are comparable to similar, arm's-length agreements,
- Set a price that's fixed by or determinable from the agreement and is reasonable at the time the agreement is executed, and
- Be binding during the owner's life as well as at death, and binding on the owner's estate or heirs after death.

Under IRS regulations, a buy-sell agreement is deemed to meet all these requirements if at least 50% of the business's value is owned by nonfamily members.

Choose the correct type of agreement

The type of buy-sell agreement you use can have significant tax and estate planning implications. Generally, the choices are structured either as "redemption" agreements, which permit or require the company to purchase a departing owner's interest, or "cross-purchase" agreements, which permit or require the remaining owners to make the purchase.

A disadvantage of cross-purchase agreements is that they can be cumbersome, especially if there are many owners. For example, if life insurance is used to fund the purchase of a departing owner's shares, then each owner will have to purchase an insurance policy on the lives of each of the other owners.

But cross-purchase agreements can also have significant advantages. For one thing, when the remaining owners purchase a departing owner's interest, they receive a stepped-up basis, reducing their taxable capital gains should they sell those interests in the future. Redemption agreements may trigger a variety of unwelcome tax consequences.

A cross-purchase agreement may also provide an estate planning advantage. Suppose, for example, that you own 35% of a business, your son owns 25% and two non-family members own 20% each. If the company redeems your shares, your family loses control over the business. But a cross-purchase agreement could be designed that gives your son the right to purchase enough of your interest to maintain control.

Review and revise as necessary

Your estate planning advisor and attorney can work with you to design a buy-sell agreement that helps preserve the value of your business for your family. It's an indispensable tool for protecting the business when owners die or exit the business and for providing liquidity for your heirs. After you have an agreement in place, review it periodically to be sure that it continues to meet your expectations. •

Comparing inter vivos and testamentary trusts

Creating and adhering to an estate plan is no simple task. Generally, the end goal of estate planning is to divide up and transfer assets to loved ones at a minimum or zero tax cost. Of course, a will is a good starting point, but it may be supplemented by various other estate planning techniques, including trusts.

Trusts are essentially used to accommodate asset transfers beyond dispositions in a will. There are two main types of trusts: the inter vivos trust and the testamentary trust. Let's take a closer look at each option.

Inter vivos trust

An inter vivos trust, sometimes called a "living trust," is created during your lifetime. The trust may be irrevocable or revocable, depending on your needs.

As the name implies, an irrevocable trust requires that you give up rights to revoke or revise the trust. For example, you can't change the beneficiaries or otherwise amend the terms. With a revocable trust, you retain the right to make changes up until the time of death.

The assets in an irrevocable trust are removed from your taxable estate, while revocable trust assets aren't. But the estate tax shelter is no longer as powerful an incentive as it used to be due to the generous federal gift and estate tax exemption. For 2023, the exemption is $12.92 million, up from $12.06 million in 2022.

A revocable trust gives you more flexibility in handling trust assets. For this reason, it's generally the preferred type of inter vivos trust.

Regardless of whether the trust is irrevocable or revocable, assets are titled in the name of the trust, giving the trust legal ownership. When the grantor passes away, the designated beneficiaries are granted access to the assets, which are then managed by a successor trustee, based on the trust terms.

Most notably, the trust's assets avoid probate, which can be a lengthy and costly process in some states. Also, probate is open to the public, so the inter vivos trust ensures privacy. Assets held in trust are seamlessly transferred to the intended recipients. This is usually the main benefit sought by parties creating an inter vivos trust.

Testamentary trust

As opposed to an inter vivos trust, a testamentary trust is created when the grantor passes away. It doesn't officially become effective until the grantor's death, and at that time it becomes irrevocable.

Unlike an inter vivos trust, your estate will likely have to pass through probate before a testamentary trust begins to operate. Once the trust is created by will, the executor adheres to the terms regarding transfers to the trust.

Because the trust must go through probate, it may be problematic if you use certain assets, such as real estate or securities. This may also cause concerns if the beneficiaries need fast access to funds.

Note that the testamentary trust may be coordinated with the gift and estate tax exemption, to ensure that your estate doesn't encounter any federal estate tax problems upon the transfer of assets. This type of trust allows you to maintain control over assets until death and provide future security for your heirs.

What's the right trust for you?

There's no right or wrong answer to that question. The choice between an inter vivos or testamentary trust often depends on your estate planning objectives, including whether you prefer to avoid probate or to maintain control over assets. Turn to your estate planning advisor for help in creating the right trust for you. •

ESTATE PLANNING PITFALL

You haven't made funeral arrangements

No one likes to contemplate his or her own death but making funeral arrangements is a necessary evil of estate planning. Family members usually are distressed in the immediate aftermath of a loved one's death. Thus, they may be hard-pressed to follow through with funeral arrangements that have been stipulated in a will or other document. Can you imagine how difficult it'll be if no arrangements have been made?

To complicate matters, family members may be scattered around the country. This can lead to logistical problems in coordinating a funeral from afar.

To make it easier for your family, designate one person (often the executor) to assume the main responsibilities regarding your funeral and related issues. Doing so can provide some assurance that your wishes will be carried out.

You should formally designate the person to handle the arrangements in your will. Absent this, at least include it in a letter of instruction.

If you don't make a formal designation, the situation may deteriorate, delaying the funeral and causing additional costs. For example, the family may have to absorb unexpected expenses in transporting remains. Bottom line: Don't leave matters to chance. Address funeral arrangements as part of your estate plan.

Knowledgeable, Responsive, Reliable, Diligent and Compassionate.

Our boutique law firm consists of five practicing estate and trust, litigation, tax and business attorneys. Our philosophy is to provide the highest levels of legal counsel, expertise and service to our clients.

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.

We do things differently. We make the complex simple, initiate the uncomfortable but necessary conversations and our entrepreneurial spirit drives us to deliver superior results. Fascinated by innovation, we strive to redefine the way we practice law every day.

We invite you to explore our website at **www.LegacyProtectionLawyers.com** or **contact us directly** at (727) 471-5868 to learn more about our firm and how we can help you.