Year End 2022 Tax, Estate and Financial Planning

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Year End 2022 Tax, Estate and Financial Planning

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Estate Planning

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Simple Estate Planning Ideas

- Consider annual exclusion gifting
  - $16,000 per person per year tax free
  - $17,000 for 2023
  - Does this really make sense for most taxpayers given the high exemption? Might it be better to make one larger gift and forgo future annual gifts? Perhaps taxpayers should revisit with their advisers whether or not to continue annual gifts to trusts as for many it may not be optimal.
  - Issues of taxpayers not tracking maximum gifts to trusts with other gifts made during the year
- Evaluate life insurance that you might own
  - Make sure it is owned in a trust and not outright (separately when was the last time an insurance consultant reviewed the policy status and performance)
  - While reviewing life insurance valuate coverage in light of the prospective reduction of the exemption in 2026 it may be advantageous not to cancel insurance that is no longer believed to be needed (it may be useful in 2026 and later), evaluate the possible exercise of conversion options on term coverage for the same reason, etc.
  - Many ILITs are not GST exempt or in old-style trusts that probably should be decanted. Making a late allocation of GST to the old ILIT or trust may be a good use of GST exemption that might otherwise expire in 2026 unsued
- Eligible to pay donee's health and education expenses if paid directly to the provider
- Accelerate gifts by making 5 years worth of 529 gifts

Estate / Gift Taxes: Current Situation

- 2022 Exemption is $12.06 million per person ($24.12 mil per couple)
  - 2023: $12.92 million ($25.84 mil per couple)
- Exemption is the aggregate amount that can be given away during lifetime and at death
- Under current law, this exemption will be automatically cut in half in 2026
- For those ready to transfer in 2022, they may wish to confirm cash flow and continue with planning already started – using forecasts and evaluating insurance protection may be helpful to identifying and filling financial gaps in a plan, making the taxpayer more comfortable and protecting the adviser. These steps can also be very protective to the practitioners involved in that type of planning.
- Taxpayers who have used up all their exemption with prior planning might “top-off” gift plans by using the 2022 and 2023 exemption amounts.
- Consider waiting until 2023 for some gifts using up exemption so that only one 2023 gift tax return has to be filed to use up the 2022 and 2023 inflation adjusted exemption amounts rather than making gifts in 2022 and again in 2023 to use the inflation adjustment amounts and avoid the need for a second gift tax return.
- The opposite planning from that noted above may be preferable for some taxpayers. For example, assume that the taxpayer is quite concerned about asset protection issues. It may be safer to make gifts spread over multiple years and reported on separate gift tax returns to corroborate the transfers made. Making a gift in 2022 of the remaining exemption and again another gift in 2023 of the new inflation adjustment exemption available in that year as two discrete transactions may be safer from the perspective of avoiding a fraudulent conveyance attack. The aggregate gift in each tax year when made separately may be a smaller percentage of overall wealth than if the gifts for 2022 and 2023 are aggregated into 2023 to minimize filing and paperwork. That may be a safer approach.

Start 2025 Planning Now

- With the exemption to be cut in half in 2026 many taxpayers should evaluate using large portions or all of their exemption before that date. Risks/issues with most estate plans are the possible application of the reciprocal trust doctrine to unravel spousal lifetime access trusts ("SLATs") or similar trusts spouses create naming each other and the general application of the step-transaction doctrine to undermine transactions (e.g. the Smaldino case).
- If a couple is contemplating SLATs or similar trusts create one trust in 2022 before year end and the other trust later in 2023 or even 2024 to separate them significantly in time. Even if the trust cannot be fully funded in 2022 by year end it "ages" the first of the two SLATs. That may help deflect a reciprocal trust challenge.
- Many couples own assets in joint name or in primarily in one spouse's name and those assets need to be retitled into separate spousal names or from one spouse to the other. If the division of assets can be done before year end that makes the initial transfer in the 2022 year and may make it safer to divide assets in a different year then the year (2023 or even better 2024) when the gifts might be made.
- Evaluate the pros/cons of creating documentation (e.g. even a simple gift letter) corroborating the retitling of assets.
- Evaluate the pros/cons of reporting inter-spousal gifts on gift tax returns even if not required.
- Don't stop with just putting different tax years and more time between retitle of assets and possible future transfers. Have substantive economic events occur after the retitle. For example, if husband has most assets and re-titles $10M to wife have wife sign a new investment policy statement and change the asset allocation corroborating her control over the assets while she owned them. If the assets is a family business or real estate LLC make a distribution and sign a new operating agreement reflecting ownership.
- Too many taxpayers may put off 2025 planning on the basis that they have several years to address that planning, but by starting now that same planning can be done with potentially less risk and greater likelihood of success.

Anti-Clawback Proposed Regs Should be Considered

The Special Rule allowing the use of the increased exemption applicable at the time of the transfer will not apply and therefore the reduced applicable exemption amount at the time of death (in 2026 or later) will apply to assets that have been transferred under the following scenarios:

1. Transfers that are brought back into the gross estate (includible transfers):
   - A. 2035 – Certain gifts/transfers made within 3 years of death
   - B. 2036 – Transfers with retained life estate (the possession, enjoyment of, or the right to income from the property OR the right to designate the persons who shall possess or enjoy the property or the income therefrom)
   - C. 2037 – Transfers taking effect at death
   - D. 2038 – Revocable Transfers
   - E. 2042 – Proceeds from life insurance (unless in a properly drafted Irrevocable Life Insurance Trust)
2. A promise to give, or promissory note that remains unsatisfied as of the date of death and is satisfied with assets included in the gross estate.
3. Transfers described in 25.2701-5(a)(4) and §25.2702-6(a)(1) – Related to retention of certain preferred interests in Family LLCs or Partnerships. Further discussion of these rules is beyond the scope of this outline.
4. Transfer, relinquishment of elimination of interest, power, or asset that would otherwise cause inclusion above within 18 months of the date of death. For example, paying off an enforceable promise to give within 18 months of date of death.

Taxpayers affected might consider paying of the promise gift to secure it. If action cannot be taken more than 18 months before death (and how can that ever be determined) taxpayers affected by this planning might choose to purchase life insurance in an ILIT to pay the tax that may be due as a result of the failure of the planning. Note that the planning cannot simply be unwound and the exemption lost restored. So taxpayers affected by the Proposed Regulations, if finalized may have effectively wasted their exemption.

Additional Estate and Trust Tax Considerations

- Consider the use of Charitable Lead Trusts (“CLTs”) in wills to reduce estate tax if the exemption in fact drops in 2026.
- The IRS extended automatic relief from two years to five years from date of death. Rev Proc 2022-32. Taxpayers whose spouse died and who did not file an estate tax return to secure the first to die spouse’s exemption should consider doing so. With the exemption being reduced by ½ in 2026 this could be particularly important to do.
- Trusts reach the maximum income tax rate at a mere $13,450 in 2022 (and $14,450 in 2023). Consider making distributions to lower bracket beneficiaries to reduce overall income tax burdens. If this cannot be achieved by year end the trust can make a distribution during the first 65 days of 2023 and elect to have it treated as if it was paid in 2022. IRC 663(b).
- Increased IRS funding may lead to increased audits of high income and high net worth taxpayers. There may be an incentive to consummate planning in 2022 and report that planning on a 2022 gift tax return, even if only part of the planning is able to be completed by year end.

Charitable Planning Strategies

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What Can You Really Gift to Charity? A Different Perspective

- How much can you give to charity? The answer is often more than you might have thought. Some donors worry whether they will run out of money if they donate too much each year. Fears of financial insecurity are often an impediment to making larger donations. Many prospective donors, especially those living with a health challenge such as multiple sclerosis, are concerned about maintaining adequate assets to deal with future financial uncertainties. Making bequests or gifts of retirement assets on death assures resource are available during your lifetime because testamentary gifts are made in the future on your death. But if access to funds for the future is a concern, there is another way to get financial comfort that may permit accelerating some of those gifts now.
- Many people who value the wonderful work their favorite charity does but are worried about making large donations today that may create financial uncertainty in future years. But there is a way many people can get comfortable making larger gifts today, and thereby accelerate the great work your favorite charitable cause does. You can use the approach recommended to determine how much you can donate or gift (e.g. to charities or your children or other donees) the maximum you can right now. Start with a discussion with your wealth adviser (or use online resources) and determine a reasonable target that you want maintain for your financial security. For example, you might wish to have an 85% likelihood of not running out of money by age 95. Some people use 100, others much lower ages. A lower age (e.g. 85) might be worrisome in light of increasing longevity, unless there is a specific known medical reason for doing so. Also, determine a confidence level that you would like to have of not running out of money by that age. For example, you might feel that an 85% level is a reasonably secure target. Some people might want a higher figure, but if you review the analysis regularly 85% or perhaps a lower figure might be adequate. Remember, if you review the analysis periodically you can always adjust in the future if you get off the financial track.
- With your target set you can have our wealth adviser forecast future financial results through age 95 (or whatever age you've selected). Next, your wealth adviser (or online tools) can adjust your budget numbers to determine what is the most money you can give away now, every year, in additional gifts (i.e. what was not reflected in your budget) to children and charities without pushing you below your financial goal of maintaining an 85% likelihood of not running out of money by age 95 (or whatever other targets you've settled on). That provides you with an estimated amount that you can gift each year (to be adjusted as you periodically revisit the numbers) without undermining your financial security. If you haven't gone through that exercise it is well worthwhile.

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General Thoughts about Charitable Trusts

- Charitable trusts can be set up as lifetime transfers or by operation of a will
- Charitable remainder trusts may be more viable or beneficial now that interests rates have increased.
- Income tax for charitable contributions through charitable trusts are limited:
  - The value of the actual interest being conveyed to the charity
  - Deductions limited – only up to 30% of adjusted gross income
- Lifetime transfers usually provide greater tax benefits than testamentary bequests because the donor will receive BOTH an income tax and gift tax charitable deduction
- Non-Grantor (complex) trusts may offer great benefits for charitable giving. Non-grantor trusts don't have to exceed the standard deduction to benefit from donations (they have no standard deduction). Trusts are not subject to the limitations of percentages of AGI that individuals are. However, trusts can only realize a charitable contribution deduction for donations of gross income. So, in contrast to individual taxpayers a trust cannot donate appreciated stock and deduct the value of the stock. The stock would have to be sold and the gain realized and then the gross income donated to charity.

Charitable Planning Strategies

Ranked from basic to most sophisticated, the following is a very broad view of the categories available to prospective donors wishing to make charitable contributions:

a. Annual Cash Donations

b. Donor Advised Funds

c. In Kind Donations of Appreciated Assets

d. QCDs (Qualified Charitable Distribution) from an IRA (for beneficiary over age 70) to charity

e. Testamentary Bequests

f. Charitable Annuities

g. Charitable Trusts

Annual Cash Donations

- Attractive for its simplicity: no valuations, not subject to IRS challenge if substantiated
- Easy to implement: no costs associated with transferring title
- Cash is suitable for any charitable organization
- Deductible up to 60% of AGI for 2022. Deductible up to 60% of Adjusted Gross Income (AGI) through 2025
- Could be missing opportunities for larger income tax deductions and estate planning
- Charitable organizations may not be able to plan for donations and spending on behalf of charitable causes

Donor Advised Funds

Benefit to Donor of using DAF instead of direct charitable contributions

- Can make large charitable contributions in year when income is much higher than usual
- Spread out charitable grants over time while getting tax deduction in specific year
- Can donate highly appreciated investments or cash (in some cases privately held investments also)
- Donor can leave a legacy for family to continue to make grants after death
- Great tool for that donor who can benefit from a charitable gift but is undecided as to which charity to give to

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Transfers of Low Basis Stock

- Need to have held stock for more than one year and the price has appreciated
  - For ordinary income and short-term capital gain property, the donor’s charitable contribution would be limited to the property’s FMV less amount that would be treated as income – essentially, the donor’s basis
  - Long-term capital gain property (usually stocks but could be other kind of property): the donor can deduct the Fair Market Value (FMV) without recognizing the realized gain
- If the donation exceeds this, you may carry forward the deduction for 5 years
- Receiving charity must have a brokerage account to accept the shares and a Board Approved policy of how to handle investments once received

Qualified Charitable Distributions (QCDs)

- Donor must be 70 ½ or older (not 72 ½)
- Donation directly from IRA to Charity
- Maximum amount is $100,000
- Can donate cash or stocks from IRA
- Satisfies Required Minimum Distribution amount
- Cannot donate to Foundation or Donor Advised Fund
- Amount of QCD is not included in income for the year
- QCD is not a deductible charitable expense
- Donation is not subject to AGI income limits
- Caution – some investment firms will give the planholder a checkbook to use to write such checks. Can you be sure that will be handled properly?

Charitable Contributions

- Up to $600 deduction for cash donations even it not itemizing

Type of Contribution	AGI Limitation	Unused Donation
Cash	60% of Adjusted Gross Income	Carries forward and used over next 5 years
Appreciated Stocks	30% of Adjusted Gross Income	Carries forward and used over next 5 years
Cash to Private Foundation	30% of Adjusted Gross Income	Carries forward and used over next 5 years
Appreciated Stock to a Private Foundation	20% of Adjusted Gross Income	Carries forward and used over next 5 years
Cash to Donor Advised Fund	60% of Adjusted Gross Income	Carries forward and used over next 5 years
Appreciated Stock to Donor Advised Fund	30% of Adjusted Gross Income	Carries forward and used over next 5 years

The IRS and Courts Tough on Proper Documentation of Donations

- The tax laws require that a taxpayer to get a contemporaneous written acknowledgment from the donee charity for gifts of $250+. This must describe the amount of cash and give a description of noncash property, confirm whether the charity provided any goods or services to the donor (and if so provide an estimate of the value of them). Code Section 170(f)(8). The IRS and Courts have gotten really tough on this so that anyone making a donation should really be certain to adhere to all the requirements of the law if they want to protect their deduction.
- In a recent case, the Court affirmed a decision denying the taxpayer a charitable contribution deduction for an airplane because the taxpayer failed to attach a contemporaneous written acknowledgment from the charity to the income tax return. Izen v. Commissioner, 5th Cir, Docket No 21-60679. Foot faults do matter.
- In another case the court denied a taxpayer a charitable contribution deduction because the taxpayer also did not have a sufficient contemporaneous written record. The Taxpayer contributed a large number of artifacts to a charity using a gift document to transfer ownership. That gift document indicated that the contribution was unconditional and irrevocable (important to assure that the donor parted with all ownership interests in the property) unless the gift agreement provided otherwise. So, the gift agreement was critical to the determination that the donation was made, but it wasn't attached to the donor's income tax return. The IRS challenged the donation as not meeting the requirements and the court agreed. Without the gift agreement it could not be corroborated that the charity did not provide goods or services that would offset the donation. Martha L. Albrecht v. Commissioner, TC Memo 2022-53.

Portfolio Allocation

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Portfolio Allocation for Tax Efficiency

- Qualified Accounts vs Nonqualified Accounts
- Make the allocation analysis more sophisticated and incorporate into the analysis non-grantor trusts, grantor trusts, GST status of trusts, state income tax situs of trusts, etc.
- Bond Income and REIT income is taxed at Ordinary Rates
- Qualified Dividends are your friend
- Municipal Bonds vs Taxable Bonds
    - Tax Equivalent Yield = Municipal Bond Yield / (1-Tax Rate)
    - Example – Muni Bond pays 6% and you are in the 37% tax bracket
        - 6% / (1-.37) = 9.52% Tax Equivalent Yield

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Year-End Capital Gains Distributions

- Payment by a mutual fund company from the proceeds of the fund’s sale of stocks throughout the year
- Consider Tax-Managed Funds
- Consider Exchange traded Funds (ETFs)

Tax Loss and Gain? Harvesting

- Tax Loss Harvesting
  - Opportunity to sell positions in a loss and generate tax benefit
  - Use loss positions to offset positions in gains
  - Carryforward losses to future years
- Tax Gain Harvesting
  - Opportunity to sell positions at long term capital gains
  - Utilize current tax laws of 20% long term capital gains
  - 0% Long Term Capital Gains rates if income less than $41,675 Single / $83,350 Married
  - Spread future tax burden over multiple periods

Tax Loss and Gain? Harvesting

- Given the large gift exemption that might decline unused for most taxpayers in 2026 consider an alternative to gain harvesting. Instead, gift appreciated assets to family members who are in a lower income tax bracket, who may pay substantially less or no tax on the long-term capital gains when the shares are sold.

IRA Strategies

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IRA Accounts

- IRAs are not automatically protected from claimants but state law in many states will protect IRA balances. This may justify setting up and growing IRA accounts, even where no tax deduction is feasible. It is a simple, no cost way to create a separate “bucket” of funds that may be asset protected.
- Requirement Minimum Distribution (RMD) before December 31st
  - If this is your first year subject to RMD, you have until April 1st
  - Penalty is 50% of the RMD if not taken on time
- COVID distributions from IRA
  - Look at paying this back

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Roth Conversions

- Take money from Traditional IRA and move into Roth IRA
- Pay tax on the amount converted at current tax rates
- No limit on amount that can be converted
- Benefits:
  - Reduces future RMD
  - Pay tax now at lower tax rates than in the future with higher taxes
  - Heirs inherit tax free money
- Review all beneficiary designations in light of the Secure Act. The stretch may no longer be available for the beneficiaries named but for some taxpayers they might wish to revise their beneficiary designations, consider trusts as beneficiaries or eliminate them.

Self-Employed

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Self-Employed Strategies

- Business Formation – LLC, S Corp, C Corp, Partnership
- Timing of Income and Expenses
- Home Office Deduction
- Augusta Rule
- Automobile Expenses
- Paying children over 7 years old
- MERP
- Retirement Plans

Employee Benefit Plans

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Employee Benefit Plans - Plan Selection

- IRA
- Roth IRA
- SEP IRA
- Solo 401k
- 401k/ PSP
- Defined benefit (DB) Plans

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IRA

- Self employed individual or employee that is not eligible to participate in a plan
- Easy to set up and maintain. Can be set up after year end. Do not have to contribute every year
- Low contribution amounts and deductibility is limited if covered by a plan or MAGI is too high
- $6,500 per year with $1,000 catch up if over 50 years old
- No tax filings and receive a deduction for the contribution
- Withdraw at any time but 10% penalty if under 59.5 years old

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Roth IRA

- Self employed individual or employee
- Easy to set up and maintain. Can be set up after year end. Do not have to contribute every year
- Low contribution amounts and limited if MAGI is too high - $138,000 if single and $218,000 if married
- $6,500 per year with $1,000 catch up if over 50 yrs.
- No tax filings and distributions are tax free
- Withdraw at any time but 10% penalty if under 59.5 yrs.
- Need to track five year aging for distributions

SEP IRA

- Self employed individual or small business owner, including those with few employees
- Easy set up and maintenance – can be established after year end as long as by tax filing deadline
- Flexible annual funding requirements, but same amounts to everyone
- Funded solely by the employer – up to 25% of compensation up to a maximum of $66,000 in 2023
- No employer tax filings
- Withdraw funds at any time, subject to 10% penalty if under 59.5 yrs.

Solo 401k

- Self employed individuals or business owner with no employees other than spouse – NO Employees
- 401k with potential higher contribution than SEP IRA
- Less administration and no filings until assets above $250,000
- $22,500 of deferrals + catch up if over 50 as well as up to 25% of compensation up to maximum of $66,000 (2023)
- Withdrawals can only be taken if 59.5 years, disability and or plan termination
- Must be set up by year end

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401k/Profit Sharing Plan

- Generally for companies with more than 10 employees
- Flexibility in Plan design – but requires administration, investment advisor and education
- More expensive and burdensome
- Salary deferrals up to $22,500 + catch up and employer can be discretionary – matching, safe harbor, PSP up to 25% of compensation up to $66,000
- Must file form 5500 and have plan testing prepared
- Loans and hardship withdrawals can be available
- Safe harbor deadline is October 1st

Defined Benefit Plans

- Appropriate for consistently profitable companies with 10 or fewer employees and older owner
- Flexibility in Plan design – but requires administration and investment advisor
- More expensive and administratively burdensome
- Annual funding requirements – need consistent cash flow
- Funded solely by the employer – up to $265,000
- 5500 filing required and testing of Plan by Actuary
- Withdrawals can only be taken if 59.5 years, disability and or plan termination
- Must be set up by year end

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Real World Example

- Safe Harbor 401k Plan with PSP and Cash Balance Option
- Approximately 12 employers and 3 owners
- Total Employer Contribution to plan was $265,700
- Tax Savings = $120,000
- Contributions to staff = $79,100

Inflation Reduction Act

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Inflation Reduction Act

- EV Credit up to $7,500
  - Stops when 200,000 units of a vehicle is sold
- Premium Subsidies for Healthcare extended to 2024
- Lower RX costs beginning in 2025
  - $2,000 annual maximum out of pocket for prescriptions
- Raise C Corp Minimum taxes
- Residential Clean Energy Credit
  - 30% credit for solar panels
- Energy Efficient Home Credit
  - $1,200/year credit for energy efficient windows, doors, insulation
  - $2,000 credit for heat pumps

Thank You!
Questions and Answers

Contact Us

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