THE ESTATE PLANNER

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Now or later
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There's no time like the present to draft your will

Making the most of charitable donations

Estate Planning Red Flag
You have significant frequent flyer miles

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Now or later

When's the right time to transfer your wealth?

To gift or not to gift? It's a deceptively complex question. The temporary doubling of the gift and estate tax exemption — to an inflation-adjusted $11.58 million in 2020 — is viewed by many as a "use it or lose it" proposition. In other words, you should make gifts now to take advantage of the exemption before it sunsets at the end of 2025 (or sooner if lawmakers decide to reduce it earlier).

But giving away wealth now isn't right for everyone. Depending on your circumstances, there may be tax advantages to keeping assets in your estate. Here are some of the factors to consider.

Lifetime gifts vs. bequests at death

The primary advantage of making lifetime gifts is that by removing assets from your estate you shield future appreciation from estate taxes. But there's a tradeoff: The recipient receives a "carryover" tax basis — that is, he or she assumes *your* basis in the asset. If a gifted asset has a low basis relative to its fair market value (FMV), then a sale will trigger capital gains taxes on the difference.

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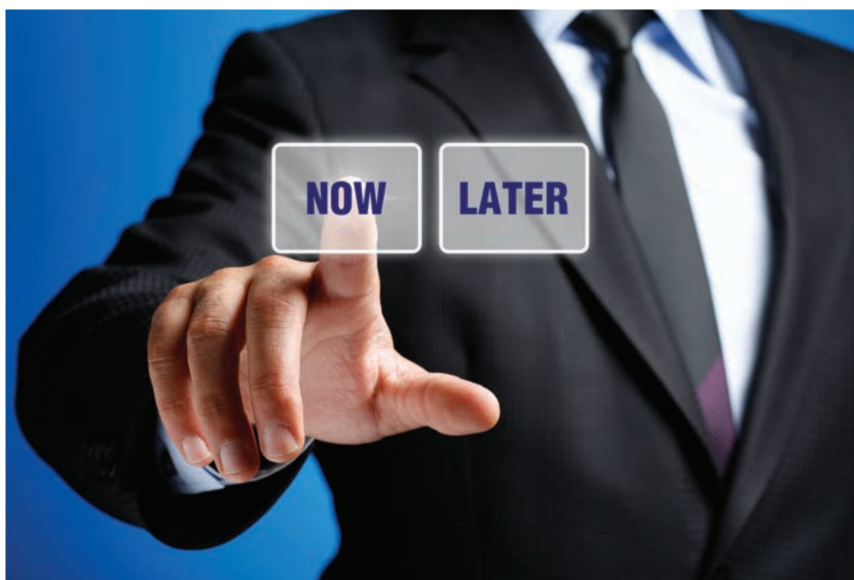
An asset transferred at death, however, receives a "stepped-up basis" equal to its date-of-death FMV. That means the recipient can sell it with little or no capital gains tax liability. So, the question becomes, which strategy has the lower tax cost: transferring an asset by gift (now) or by bequest (later)? The answer depends on several factors, including the asset's basis-to-FMV ratio, the likelihood that its value will continue appreciating, your current or potential future exposure to gift and estate taxes, and the recipient's time horizon — that is, how long you expect the recipient to hold the asset after receiving it.



Here are three examples. To keep things simple, we'll always assume that you and your heirs are subject to tax on capital gains at a rate of 23.8% (the top capital gains rate of 20% plus the 3.8% rate on net investment income) and that the gift and estate tax rate is 40% of amounts in excess of the applicable exemption.

Example #1. You have $8 million in publicly traded securities with a $3 million basis and $2 million in

Hedging your bets

Determining the right time to transfer wealth can be difficult, because so much depends on what happens to the gift and estate tax regime in the future. It may be possible to reduce the impact of this uncertainty with carefully designed trusts.

Let's say you believe the gift and estate tax exemption will be reduced dramatically in the near future. To take advantage of the current exemption, you transfer appreciated assets to an irrevocable trust, avoiding gift tax and shielding future appreciation from estate tax. Your beneficiaries receive a carryover basis in the assets, so they'll be subject to capital gains taxes when they sell them.

Now suppose that, when you die, the exemption amount hasn't dropped, but instead has stayed the same or increased. To hedge against this possibility, the trust gives the trustee certain powers that, if exercised, cause the assets to be included in your estate. Your beneficiaries enjoy a stepped-up basis and the higher exemption shields all or most of the asset's appreciation from estate taxes.

other assets. You haven't used any of your exemption amount. If you give the securities to your son, who sells them immediately, he'll owe $1.19 million in capital gains taxes [23.8% × ($8 million - $3 million)]. Suppose, instead, that you hold the securities for life, that the inflation-adjusted exemption in the year you die is $12 million, and that the securities' value has grown to $11 million. If your son inherits the securities, he'll receive a stepped-up basis of $11 million and can sell them tax-free. Your estate will be subject to estate taxes of $400,000 [40% × ($13 million - $12 million exemption)]. In this scenario, holding the securities is the better strategy from a tax perspective.

Example #2. Same facts as in the first example, except that your son plans to hold the securities for life rather than sell them. In this scenario, gifting the securities now is the better strategy because, by holding them, your son avoids capital gains taxes and there's no estate tax because all future appreciation is removed from your estate.

Example #3. Again, the same facts as in the first example, except that when you die the exemption has dropped to $6 million, so your estate is subject to estate taxes of $2.8 million [40% × ($13 million - $6 million exemption)]. In this scenario, gifting the securities now results in a substantially lower tax bill, even if your son sells them immediately.

Other factors

These three previous examples are highly simplified to illustrate the decision-making process. In the real world, many other factors may affect the overall economics, including an asset's income-earning potential, the applicability of state income and estate taxes, and potential changes in capital gains and gift and estate tax rates.

Dealing with uncertainty

Determining whether to hold or gift assets is challenging because the best course of action may depend on future events. Work with your estate planning advisor to monitor legislative developments and adjust your estate plan accordingly. And consider tools for building flexibility into your plan to soften the blow of future tax changes. (See "Hedging your bets" above.)

There's no time like the present to draft your will

A well-crafted, up-to-date will is the cornerstone of an estate plan. Importantly, it can help ease the burdens on your family during a difficult time. To ensure that your will covers all the bases, it's imperative that you know what provisions to include and what is best to leave out.

Begin with the basics

Typically, a will begins with an introductory clause, identifying yourself along with where you reside (city, state, county, etc.). It should also state that this is your official will and replaces any previous wills.

After the introductory clause, a will generally explains how your debts and funeral expenses are to be paid. In the past, funeral expenses were often paid out of the share of assets going to your children, instead of the amount passing to your spouse under the unlimited marital deduction. However, now that the inflation-adjusted federal gift and estate tax exemption has increased to $11.58 million for 2020, this may not be as critical as before. The provisions for repaying debt generally reflect applicable state laws. Consult with your estate planning advisor or attorney concerning your options.

Don't include specific instructions for funeral arrangements, unless you've also included them elsewhere. It's likely that your will won't be accessed in time. Spell out your wishes in a letter of instructions, which is an informal letter to your family.

A will may also be used to name a guardian for minor children, or for an older child that is considered to be legally incapacitated. To be on the safe side, name a backup in case your initial choice is unable or unwilling to serve as guardian or predeceases you.

Discuss estate taxes

The next section of the will may address estate taxes. Remember that this isn't necessarily limited to federal estate tax; it can also apply to state death taxes. You might arrange to have any estate taxes paid out of the residuary estate that remains after assets have been allocated to your spouse.

Furthermore, if you're using a testamentary trust, it may be required to pay any resulting estate taxes. Coordinate this with other aspects of your will. You can't anticipate every possible scenario, so rely on your advisor or attorney for guidance.

Make bequests

One of the major sections of your will — and the one that usually requires the most introspection — divides up your remaining assets. Outside of your residuary estate, you'll likely want to make specific bequests of tangible personal property to designated beneficiaries. For example, you might leave a family heirloom to a favorite niece or nephew.

When making bequests, be as specific as possible. Don't simply refer to jewelry or other items without describing them in detail, especially if you own

multiple rings or watches or the like. This can avoid potential conflicts after you're gone.

If you're using a trust to transfer property, make sure you identify the property that remains outside the trust, such as furniture and electronic devices. Typically, these items won't be suitable for inclusion in a trust.

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Appoint an executor

Name the executor — usually a relative or professional — who has the responsibility to administer your will. Of course, this should be a reputable person whom you trust. Also, include a successor executor if the first choice is unable to perform these duties. You may, if so inclined, use a professional, either as the primary executor or as a backup.

Be sure to meet all the legal obligations for a valid will in the applicable state and keep it up to date. Sign the will, putting your initials on each page, with your signature attested to by witnesses. Include the addresses of the witnesses in case they ever need to be located. Don't use beneficiaries as witnesses. This could lead to potential conflicts of interest.

Keep in mind, also, that a will that's valid in one state is valid in others. So, if you move you won't necessarily need a new will, although of course there may be other reasons that it makes sense to update it at that time.

Stop procrastinating

It's never pleasant to consider your death, but having a will is vitally important if you want to have a say in what happens to your children and wealth when you're gone. Contact your estate planning advisor or attorney today to begin the process.

Making the most of charitable donations

Conventional wisdom says that an illiquid taxpayer who wishes to make a charitable contribution is better off donating appreciated assets rather than cash. Why? Because in addition to receiving a charitable income tax deduction, the donor also avoids the capital gains taxes that would've been triggered had he or she sold the assets and donated the proceeds.

Often, the conventional wisdom holds true. But in some cases, it's preferable to liquidate appreciated assets and donate cash, especially since the Tax Cuts and Jobs Act temporarily increased the limit on deductions for cash donations to public charities from 50% to 60% of adjusted gross income (AGI), compared to 30% of AGI for appreciated assets.

The right strategy for you depends on several factors, including your income level, the size of your charitable donations and the amount of unrealized gain on assets you're considering donating.

A charitable deduction primer

Taxpayers who itemize are entitled to deduct the value of cash or other assets donated to qualified

charities. But the tax code imposes annual limits on these deductions, depending on the type of assets donated, the type of organization receiving them and, in some cases, the purpose of the donation.

Generally, for donations to public charities, the limit is 30% of AGI for appreciated assets and 60% of AGI for cash. Unused deductions may be carried forward for up to five years after the year the donation is made.

Appreciated assets vs. cash

To determine whether you should donate appreciated assets or cash to charity, estimate your income for the gift year and the five-year carryover period, and then calculate how the type of donation will affect your tax liability over that six-year period. For example:

Frank, a single taxpayer, earns $500,000 annually, all of which is ordinary income. Assume that his only itemized deductions are for charitable gifts. He'd like to donate $2 million to charity and is considering a gift of $2 million in stock with a cost basis of $1.25 million. If Frank donates the stock, he'll be entitled to deduct $150,000 per year (30% × $500,000), leaving him with $350,000 in ordinary income and a tax liability of approximately $98,000, for a total of $588,000 during the six-year period. With this strategy, Frank will essentially lose out on the tax benefit of more than half of his $2 million contribution.

Suppose, instead, that Frank sells the stock and donates $2 million in cash. In the current year, he'll have $750,000 in capital gain plus $500,000 in ordinary income. But he'll also have a $750,000 charitable deduction (60% × $1.25 million), which offsets all his ordinary income plus $250,000 of his capital gains, leaving him with $500,000 in capital gains and a $100,000 tax liability in year one. In years two through five, he'll enjoy a charitable deduction of $300,000 (60% × $500,000), leaving him with $200,000 in ordinary income and about $45,000 in taxes in each of those years. In year six, he'll deduct the remaining $50,000 of his original $2 million gift, leaving him with $450,000 in ordinary income and about $133,000 in taxes. His total tax liability for the six-year period is approximately $413,000. By donating cash rather than stock, Frank saves about $175,000 in taxes over six years.

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Another option

There's another way illiquid taxpayers can take advantage of higher charitable deduction limits

for cash donations: Borrow funds against appreciated assets and donate those funds to charity. This approach may be attractive to taxpayers who wish to hold onto those assets and avoid triggering capital gains taxes. If you adopt this strategy, of course, you'll need to consider interest payments and other borrowing costs that may offset some of the tax savings.

Crunch the numbers

If you're charitably inclined but lack liquid assets sufficient to satisfy your philanthropic objectives, the type of property you donate can have a big impact on the after-tax costs of your gifts. Before you donate, ask your estate planning advisor to crunch the numbers and determine the most tax-effective strategy.

ESTATE PLANNING RED FLAG

You have significant frequent flyer miles

If you're a frequent traveler, you may have accumulated hundreds of thousands or even millions of frequent flyer miles. The value of these miles may be significant, so it's important to determine whether you can include them in your estate plan and share them with your loved ones.

Your ability to transfer miles at death (or any other time) is governed by your contract with the airline, which requires you to accept a long list of terms and conditions when you join its frequent flyer program. Most programs make it clear that miles aren't your property and that you're not entitled to transfer them during your lifetime or at death. But many programs provide that the airline may transfer miles to authorized persons *at their discretion*.

For example, American Airlines' rules state that miles are nontransferable, but that, in the event of death, the airline "in its sole discretion, may credit accrued mileage to persons specifically identified in court approved divorce decrees and wills upon receipt of documentation satisfactory to American Airlines and upon payment of any applicable fees." Anecdotal evidence indicates that American routinely grants these requests and often waives the fees.

There are no guarantees, but you can maximize the chances that an airline will honor your wishes by including a provision in your will leaving your frequent flyer miles to one or more beneficiaries. With airlines that strictly prohibit transfers, there are stories of some people getting around the rule simply by giving their family members their login credentials and authorizing them to use their miles. Keep in mind, though, that this strategy generally violates the program's contractual terms.

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- A creative and imaginative approach that focuses on finding solutions, not problems.
- Accessible attorneys who give clients priority treatment and extraordinary service.
- Effectiveness at a fair price.

Since 1925, Shumaker has met the expectations of clients that require this level of service. Our firm offers a comprehensive package of quality, experience, value and responsiveness with an uncompromising commitment to servicing the legal needs of every client. That's been our tradition and remains our constant goal. This is what sets us apart.

Estate planning is a complex task that often involves related areas of law, as well as various types of financial services. Our clients frequently face complicated real estate, tax, corporate and pension planning issues that significantly impact their estate plans. So our attorneys work with accountants, financial planners and other advisors to develop and implement strategies that help achieve our clients' diverse goals.

Shumaker has extensive experience in estate planning and related areas, such as business succession, insurance, asset protection and charitable giving planning. The skills of our estate planners and their ability to draw upon the expertise of specialists in other departments — as well as other professionals — ensure that each of our clients has a comprehensive, effective estate plan tailored to his or her particular needs and wishes.

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