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FAMILY OFFICE

Planning for Year-end 2022 & Beyond



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As the leaves begin to change colors, and there is a chill in the morning air, we turn our attention to year-end matters. This year has been tumultuous in the financial world with interest rates rising dramatically, heightened volatility in the equity markets, and inflation hitting levels not seen in 40 years.

There were several proposed legislative changes in the past two years; however, 2022 began and is expected to end with no new Federal estate and gift tax changes. While changes could resurface, for now, attention is elsewhere.

As we close out 2022 and think ahead, our goal is to provide you with timely and relevant planning considerations specific for individuals and families with exceptional wealth. We understand these individuals and families face different complexities as well as have unique planning opportunities available.

Make a Year-end Checklist & Check it Twice

With a couple months left in 2022, this is an opportune time to make a year-end planning checklist and check it twice. Taking advantage of possible tax breaks and avoiding pitfalls could save you money. Here are our top 10 year-end checklist items for your consideration:

- 1.** Take advantage of annual exclusion, tax-free gifts of up to \$16,000 (\$32,000 for married couples) per gift recipient.
 - i.** The 529 Plan rules allow for front-loading gifts. Consider “supersizing” your gift by funding a 529 Education Plan using your annual exclusion x5. Also, assets grow tax free and if used for educational expenses, any future appreciation is not subject to taxation.
- 2.** Make other tax-free gifts of unlimited amounts directly to medical and educational institutions.
- 3.** If gifts to recipients exceed the annual exclusion amount, use all or a portion of your gift/estate tax lifetime exemption (\$12.06M per individual and \$24.12M for married couples) to make taxable gifts, in trust or outright. These exemptions are scheduled to revert to lower levels (\$5M adjusted for inflation) on January 1, 2026.
 - i.** Even if you are on the hook to pay gift tax (i.e., no remaining exemption available), removing assets from your estate to include any future appreciation of those assets can help reduce your overall estate tax liability.
 - ii.** Taxable gifts made during lifetime can be more tax-efficient than testamentary gifts.
 - iii.** Using illiquid assets may be more tax-efficient due to possible discounts applied to the value of the asset transferred such as an LLC interest. Appraisals apply; thus, timing may not work at this late date. However, in some cases, you may be able to transfer cash and substitute illiquid assets later.
 - iv.** Forgiveness of debt is another way to make use of your exemption without parting with any funds to make the gift.
 - v.** Apply your lifetime generation-skipping tax (GST) exclusion (\$12.06M per individual and \$24.12M for married couples) when taxable gifts benefit individuals more than one generation removed from you (aka Skip Persons) to avoid the separate GST tax.
- 4.** Update your beneficiary designations and communicate your estate plan to avoid misunderstandings and help prepare inheritors.
- 5.** “Bunch” charitable gifts typically gifted over several years to potentially take advantage of a larger charitable deduction, especially with the limitations or suspensions of several other itemized deductions.
 - i.** Donating certain long-term appreciated assets to select charities may provide more “bang for the buck”. You may get an income tax deduction based on the FMV of the donated asset as well as avoid paying capital gains tax on the asset’s unrealized appreciation.
 - ii.** Donor-Advised Funds (DAF) are one way to bunch gifts efficiently.
 - iii.** In general, you can deduct up to 60% of your AGI for cash gifts. However, in other cases you may be limited to 20%, 30%, or 50% depending on the type of contribution and the organization.
 - iv.** Living in a state with low- or no-income taxes may mean less likelihood of being subject to AMT. In this case, charitable gifts may be even more attractive because the charitable deduction is worth 37% under the regular tax system vs. 28% under the AMT system.
 - v.** Make sure you are on track to make qualifying distributions under the 5% Minimum Distribution Rule from your private or family foundation for charitable purposes.

6. Review your investment portfolio with your advisor to harvest capital losses to offset potential capital gains.

7. Max out your retirement accounts (\$20,500 to 401(k) + \$6,500 more if age 50+; \$6,000 to IRAs + \$1,000 more if age 50+). Note that contribution deadlines are later - April 18, 2023 - for IRAs and Roth IRAs.

8. Take required minimum distributions on time to avoid possible penalties, and/or consider donating up to \$100,000 directly to a qualified charity to avoid taxable income. You must be 70 ½ or older to take advantage of this option.

9. Talk with your CPA about the generous write-off's available to business owners.

10. Individuals with income over \$400,000 might want to consider accelerating income and deferring deductions to offset future income that could be taxed at higher rates.

Below are the Current and 2023 Individual Tax Federal Income Tax Rates

2022 FEDERAL INCOME TAX RATES

Tax Rate	Single	Married Filing Jointly	Heads of Household
10%	\$0 to \$10,275	\$0 to \$20,550	\$0 to \$14,650
12%	\$10,275 to \$41,775	\$20,550 to \$83,550	\$14,650 to \$55,900
22%	\$41,775 to \$89,075	\$83,550 to \$178,150	\$55,900 to \$89,050
24%	\$89,075 to \$179,050	\$178,150 to \$340,100	\$89,050 to \$170,050
32%	\$179,050 to \$215,950	\$340,100 to \$431,900	\$170,050 to \$215,950
35%	\$215,950 to \$539,900	\$431,900 to \$647,850	\$215,950 to \$539,900
37%	\$539,900 or more	\$647,850 or more	\$539,900 or more

Source: Internal Revenue Service

2023 FEDERAL INCOME TAX RATES

Tax Rate	Single	Married Filing Jointly	Heads of Household
10%	\$0 to \$11,000	\$0 to \$22,000	\$0 to \$15,700
12%	\$11,000 to \$44,725	\$22,000 to \$89,450	\$15,700 to \$59,850
22%	\$44,725 to \$95,375	\$89,450 to \$190,750	\$59,850 to \$95,350
24%	\$95,375 to \$182,100	\$190,750 to \$364,200	\$95,350 to \$182,100
32%	\$182,100 to \$231,250	\$364,200 to \$462,500	\$182,100 to \$231,250
35%	\$231,250 to \$578,125	\$462,500 to \$693,750	\$231,250 to \$578,100
37%	\$578,125 or more	\$693,750 or more	\$578,100 or more

Source: Internal Revenue Service

As you think about income tax rates; in general, one consideration is, rather than “trap income” at a higher tax bracket in a trust, consider passing out the taxable income to a family member(s) in a lower income tax bracket. A trust will be taxed at 37% on all income over \$13,451 (expect adjustments for inflation in 2023).

Some Things Don't Change Much

As we look ahead to 2023, there are certain gifting strategies that tend to remain relevant and timely, regardless of the current tax environment or adjustments to amounts. We encourage you to think about how these strategies continue to fit into your overall gifting plan throughout the year.

They include:

- Maximize annual tax-free gifts (amount per gift recipient increases to \$17,000 – \$34,000 for married couples – in 2023).
- Make unlimited payments for education or health care expenses directly to institutions for qualified expenses.
- Use your gift/estate tax lifetime exemption to make taxable gifts (exemptions increase to \$12.92M per individual – \$25.84M for married couples – in 2023). Unused exemption is portable to your surviving spouse if not fully used by the first spouse-to-die during life or at death. Certain rules may apply if remarried.
- Apply your GST tax exclusion for gifts made to Skip Persons. The exclusion is not portable to the surviving spouse – Use it or lose it.
- Consider gifting promissory notes by forgiving outstanding debt.
- Donate to charities meaningful to you.
- Max out retirement accounts (increases in 2023 to \$22,500 to 401(k) + \$7,500 more if age 50+; \$6,500 to IRAs + \$1,000 more if age 50+).

Some Things Do Change: Planning in a High Interest Rate Environment

Interest rates, including both AFR and §7520 rates, affect estate planning. The AFR rate is used to calculate the minimum interest charged for loans such as intra-family loans whereas the §7520 rate is used to calculate annual payments for specific planning strategies. The success of specific planning strategies hinges greatly on a low- or high-interest rate environment. With interest rates rising, you may have an opportunity to capitalize on the following planning strategies because of a higher §7520 rate to include:

Qualified Personal Residence Trust (QPRT): A strategy used to transfer a personal residence to trust beneficiaries. The person who transfers the residence to the trust, the Grantor, may continue to use the residence for a period – the QPRT term. At the end of the QPRT term, ownership of the residence passes to the trust beneficiaries.

The initial transfer is a taxable gift. To determine the gift amount, you must calculate the value of the retained interest of the Grantor. The higher the §7520 rate, the lower the taxable gift amount. Why? The calculated right of the Grantor to use the residence during the QPRT term is higher, resulting in a lower taxable gift amount. Possible benefits and other considerations for the Grantor include:

- Reduce the Grantor's taxable estate by removing the value of the residence and its future appreciation. To realize this benefit; however, the Grantor must survive the QPRT term, or the residence is included in the Grantor's taxable estate.
- The Grantor continues to enjoy the residence rent-free, and associated income-tax deductions, during the QPRT term. After the QPRT term, the Grantor may rent back the residence for FMV rent if desired.
- Avoid gift tax liability by using the Grantor's lifetime gift tax exemption and/or locking in the value of the Grantor's home at the time of transfer.
- QPRT income and expenses are taxed to the Grantor, which may be viewed as additional gifts to the trust beneficiaries since they aren't incurring these costs during the QPRT term.
- The transfer is irrevocable.
- If the residence has a mortgage, subsequent mortgage payments made by the Grantor during the QPRT term are counted as part of the taxable gift amount. Also, the Grantor no longer owns the residence once it is transferred to the QPRT. Thus, the residence cannot be used for future collateral.

Charitable Remainder Trust (CRT): A strategy used to transfer assets to your favorite charity after a period – the CRT term – and generate a possible stream of income to the Grantor, or other beneficiaries, during the CRT term. Contributions to a CRT qualify for a partial charitable tax deduction based on the present value of the future remainder interest transferring to the charity, which is calculated using the §7520 rate. The higher the §7520 rate, the higher the value of the charitable interest and resulting deduction (limits may apply based on asset type). Furthermore, CRTs must pass certain IRS rules such as minimum payout rates to the Grantor, or other beneficiaries, during the CRT term and a 10% minimum remainder value test. A higher §7520 rate increases the likelihood of meeting these tests.

CRT investment income is tax-exempt, which makes the CRT a good option for asset diversification and preservation. For example, waiting to sell low-basis assets with high built-in capital gains post contribution to the CRT allows for a tax-exempt sale at the Federal level (state-specific laws may apply). Possible benefits and other considerations for the Grantor include:

- Flexibility and some control over intended charitable beneficiaries.
- Can transfer cash or property.
- The transfer is irrevocable.
- CRT can benefit public charities or private foundations.
- May combine a CRT with a DAF for greater flexibility.
- Provides the Grantor, or other beneficiaries, a stream of income during the CRT term in the form of a fixed annuity amount or fixed percentage, based on the annual CRT balance.
- The Grantor, or other beneficiaries, pay income tax on the income received.
- The Grantor may use income-tax savings or income from the CRT to fund an Irrevocable Life Insurance Trust (ILIT). Purchasing life insurance may be a strategy to replace the assets contributed to the CRT if the Grantor is concerned about continuing to benefit other beneficiaries while also meeting philanthropic goals. ILITs present other estate tax benefits to the Grantor as well.
- Reduce estate taxes by removing assets from the Grantor's estate.

What Else to Consider

“Tried and true” gifting strategies that don’t change much in terms of relevance and timeliness year after year as well as planning strategies that particularly perform better in certain market environments are highlighted above. Before closing there are a few other planning ideas to emphasize and consider that may be pertinent as you think ahead to 2023 and beyond. They are:

Convert your Traditional IRA to Roth IRA: Possible market declines in the value of your Traditional IRA portfolio value may allow for a Roth conversion to be completed at a reduced tax cost. In other words, completing the conversion before the underlying assets rebound in value may allow you to pay tax on a smaller asset base. Future distributions from Roth IRAs typically distribute tax free to you and your beneficiary(ies) post-death if certain rules relating to the timing of withdrawals are met. This is possibly the most advantageous aspect of a Roth IRA. Additionally, there are no required distributions from a Roth IRA on converted assets. In most cases, inherited Roth assets paid to a non-spouse beneficiary(ies) are paid out tax-free if withdrawn within 10 years. Spouses who inherit a Roth IRA can treat the account as their own.

The Family LLC: Family LLCs continue to be popular and used for both business and estate planning reasons. In general, family LLCs provide great flexibility in allocating profits and capital, shifting income and asset appreciation from senior to younger generations who may be in lower tax brackets. A family LLC is created by transferring property from an individual, a parent, for example, to the LLC in exchange for membership interests. After the initial capitalization, the parent may sell/gift LLC interests to their children or grandchildren outright or in trust, potentially at a discount value. Family LLC interests come with certain rights and control and are governed by written articles of organization and an operating agreement.

Get in Touch

Other considerations include:

- May make use of your gift/estate tax lifetime exemption to gift LLC interests.
- Parent may retain managerial/voting interest for control purposes such as how assets are invested or sold, when distributions can be made, and approving transfers of LLC interests. Use of an independent manager may be prudent to avoid estate inclusion.
- The family LLC must have a viable business purpose.
- In general, a Family LLC offers creditor protection with respect to debtors.
- The family LLC does not have to be situated in the same state you reside, which may be important if issues such as anonymity, court access, and state income tax are important considerations.

Any of these planning strategies can be complex and require expertise to properly establish. You are not alone in the decision-making process; we can help coordinate with your other advisors. Call your Callan Family Office advisor today.

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