2023

Diversified Trust

YEAR-END PLANNING

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The end of the year presents a number of opportunities for families to engage in tax planning. While not all of these strategies will apply to every family, even engaging with one or two can make a meaningful impact. Our advisors are working with our clients to identify options and provide creative solutions.

Key Takeaways:

- Making gifts of $17,000 to children and grandchildren, or paying tuition or medical expenses directly, can be an efficient way to shift wealth.
- Families with projected estates around $15 million+ should initiate conversations with their advisors about 2026 estate tax planning.
- Take advantage of tax-loss harvesting before the end of the year.
- Many families can benefit from a donor-advised fund for charitable giving.

Estate and Gift Tax Planning

ANNUAL EXCLUSION GIFTS

In 2023, each individual is able to make an annual gift of up to $17,000 (or $34,000 per couple) to an unlimited number of designated recipients without using any estate and gift tax exemption, which is currently $12.92M, but could change dramatically in the coming years. This means an individual with nine grandchildren could give each $17,000 without dipping into his or her estate tax exemption. If the exclusion amount goes unused by the end of the year, it cannot be carried forward.

DIRECT PAYMENT OF TUITION AND MEDICAL EXPENSES

Another strategy to transfer money out of an individual's estate without using any estate and gift tax exemption is to pay tuition or medical expenses directly for children or grandchildren. In order to avoid any estate and gift tax consequences, these payments must be paid directly to the educational institution or medical provider and cannot pass through another party. These payments can be made without limit on anyone's behalf up to the expense amount.

USING INCREASED ESTATE TAX EXEMPTION BEFORE SUNSET

Currently, each individual can leave up to $12.92M to heirs at death free of estate tax. The same is true for gifts made to children or grandchildren [Gifts of up to $12.92M do not trigger any gift tax.]. In 2024, after an adjustment for inflation, the estate and gift tax exemption will increase to $13.61M per person. This means that in 2024, most couples can give away during lifetime, or leave behind at death, $27M to heirs without paying any estate or gift tax. While these numbers are generous, they are not slated to last. If Congress does nothing between now and January 1, 2026, these numbers will get cut in half. Beginning in 2026, families with estates of around $15M+ (after inflation adjustments) will need to consider estate tax planning. While that is still a large estate, when a life insurance death benefit is included (an asset many families don't consider because it's not a current asset, and it passes income tax free but not estate tax free), many families should be thinking more carefully about estate taxes in 2026 than they have over the last several years.

We expect to see a rush of planning in 2025. To beat the crowds and to be sure that they are able to carry out more thoughtful planning, we are encouraging clients in this in between space to take a close look at their estate tax situation and how they can use the increased exemption before it sunsets. A common solution for using the increased exemption is funding a trust where the spouse is the primary beneficiary and perhaps even the trustee (commonly known as a spousal lifetime access trust or a SLAT). This gives the spouse access to the trust assets, which can ease the pain of making such a large gift.

Many families have planning fatigue from years of hearing tax professionals tell them about changes that are imminent but never come to fruition. A different take on this type of planning for clients who want to take a wait-and-see approach is to make a loan to a SLAT rather than a gift. The spouse setting up the trust holds a promissory note from the trust and can choose to forgive the loan if Congress lets the increased exemption lapse. Until the Grantor forgives the loan, he or she will not have given up any meaningful access or control to the trust assets.

Taking advantage of the increased exemption requires making a gift of greater than $7M, which is a very large gift for many families. Moreover, SLATs can become a problem in the event of a divorce or the death of the beneficiary spouse. In the rush to use up this exemption, families should be careful not to over-plan and should be sure that liquid assets available to the donor spouse remain sufficient.

INCREASED INTEREST AND 7520 RATES

Key rates that drive many of the more advanced planning strategies have gone up dramatically over the last two years. This has made many of these strategies less appealing, but a couple of strategies that involve the gift of a remainder interest should be more attractive with higher rates.

MID-TERM APPLICABLE FEDERAL RATES		
November '21	November '22	November '23
1.19%	4.37%	4.69%

7520 RATES		
November '21	November '22	November '23
1.40%	4.80%	5.60%

A charitable remainder trust (CRT) is a trust in which the person establishing the trust retains a right to receive a fixed amount for a period of years from the trust and leaves the balance at the end of that period to charity. The charitable deduction is equal to the present value of the remainder interest, and the 7520 rate is a key factor in determining present value. Higher rates used in the present value calculation mean larger charitable deductions.

Similarly, families establishing qualified personal residence trusts (QPRTs) benefit from higher rates. A QPRT is an estate and gift tax strategy where an individual gives a house used as a primary or secondary residence to a trust but reserves the right to live in the house for a period of years. At the end of the period, the individual has to lease the property from the trust in order to continue to use it. In this case, the 7520 rate is used to determine the value of the gift after taking the retained interest into account, and higher rates equate to a smaller gift.

Lastly, for families who have done advanced planning involving promissory notes, now is a good time to take a careful look at those notes and check the maturity date. Many such notes were prepared with the assumption that they could be refinanced at the end of the term, but that may not make as much sense now as it did in a low-interest-rate environment. Evaluating options with a tax professional before maturity could save families from a major headache in the future.

Income Tax Planning

TAX-LOSS HARVESTING

Tax-loss harvesting is a strategy that involves selling stock positions, which are at a loss, to offset capital gains and effectively lower or eliminate capital gains tax on other assets. Losses are carried forward indefinitely, meaning they don't have to be used in that same tax year. Additionally, $3,000 can also be applied to offset ordinary income.

When using this strategy, investors should pay careful attention to the wash-sale rules, which prevent an individual from repurchasing a stock that has been sold – or a substantially similar one – in any account until after 30 days have passed. If this rule is violated, the losses incurred will be disallowed. The wash-sale rules help ensure that taxpayers have economic risk associated with claimed losses.

If there are any questions concerning tax-loss harvesting, please call our office so we can put you in touch with your Portfolio Manager.

CONFIRM TAX WITHHOLDING AND ESTIMATED PAYMENTS

If income will be significantly higher in 2023 than in 2022, individuals should increase estimated tax payments or withholding to make up the difference and to avoid an underpayment penalty. To avoid such penalties, 2023 estimated payments should be at least (a) 110% of 2022 tax liability, or (b) 90% of the 2023 tax due. Families should consult their tax advisors to determine whether estimated payments are on track.

BONUS DEPRECIATION PHASE OUT

Since the beginning of 2018, business owners have benefited from 100% bonus depreciation on most purchases of equipment and certain other assets used in their business. That number has dipped to 80% in 2023 and will continue to drop by 20 percentage points per year until it is totally phased out starting in 2027. Business owners thinking about making large purchases of eligible property may consider doing so now.

Retirement Planning

REQUIRED MINIMUM DISTRIBUTIONS (RMDS) AND QUALIFIED CHARITABLE DISTRIBUTIONS (QCDS)

There are a few things to consider in regards to retirement planning as the year end approaches, one of which is Required Minimum Distributions (RMDs). RMDs begin at age 73 (or 75 for retirees who attain age 74 after December 31, 2032) for the account owner and are subject to a 50% excise tax if not taken by December 31, or if the distribution taken is not large enough. Those who do not need the income can consider making a Qualified Charitable Distribution (QCD) to a qualified charity. This satisfies the RMD requirement while excluding the distribution from taxable income. This can be a more tax-efficient way to make the charitable gift rather than taking the RMD and subsequently making a gift. IRA account owners must be age 70 ½ and up to make a QCD, and the amount is capped at $100,000 per year. RMDs are not required this year for inherited IRAs where the participant died after December 21, 2019.

ROTH IRA CONVERSION

For those with traditional IRAs, the end of the year is a good time to consider converting to a Roth IRA. Account holders do not pay tax on withdrawals from Roth IRAs, and those accounts do not have required minimum distributions. Converting to a Roth IRA requires paying tax on the balance of the account at ordinary income rates, which is the major downside to converting, but a conversion could make sense for those with offsetting ordinary losses or who are in a low income tax bracket and want to invest for the future.

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Charitable Planning

The end of the year is a time when many families consider making charitable gifts to organizations they support. Direct gifts to public charities can be very tax efficient. Sometimes, particularly in abnormally high-income years, clients want to make a large gift but don't know where or don't want to give such a large lump sum to a single organization.

For these families, a donor-advised fund (DAF) is the ideal vehicle. DAFs provide a way to fund a charitable-giving account where the "Advisor" directs grants to other charities over time. Unlike private foundations, DAFs do not have a minimum grant requirement each year. The money in the DAF can be invested alongside a family's other assets and can grow. DAFs can be used to front-load charitable giving for a period of years. For families who do not typically itemize deductions, a front-loaded DAF could allow the family to use the standard deduction for a few years. Some families, who are initially looking to establish a private foundation, generally resort to using a DAF because of its ease of administration and relative flexibility.

Other charitable structures to consider are charitable remainder trusts (discussed above) and charitable lead trusts (CLTs). Charitable lead trusts are the reverse of charitable remainder trusts – the trust sends a fixed amount to charity each year (the lead gift) for a period of years, and the balance of the trust comes back to the individual who funded the trust at the end of the term. A DAF can be used as the charitable beneficiary in both a CRT and CLT. Both of these so-called split interest trusts can be particularly useful vehicles ahead of the sale of a capital asset.

AGI LIMITS

Deductions for charitable contributions are limited to a certain percentage of a taxpayer's adjusted gross income (AGI).

TYPE OF ORGANIZATION	CASH	LONG-TERM CAPITAL GAIN ASSETS
Public Charity or DAF	60% of AGI	30% of AGI (Deduction equal to FMV)
Private Foundation	30% of AGI	20% of AGI (Deduction equal to FMV if publicly traded stock)

Because individuals can deduct the fair market value (FMV) of long-term capital gain assets without recognizing the gain, these can be particularly attractive assets to give to charity.

Short-term capital gain assets are generally treated like cash, but deductions are limited to basis rather than FMV. AGI limits and deductibility of appreciated assets contributed to CRTs and CLTs generally look to the nature of the charitable beneficiary. If charitable contributions exceed the AGI limits above, those deductions are carried forward into the next year, and taxpayers have a five-year period to use the deductions.