

### Starting Soon.... 16<sup>th</sup> ANNUAL INTERGENERATIONAL ESTATE PLANNING CONFERENCE November 19, 2021



# Welcome! Housekeeping:

1. **Conference Materials** can be found at: <u>www.pierrolaw.com/resources</u>

- 2. Accountants: fill out application for four free CPE's. Thanks to Marvin and Company for sponsoring these credits!
- 3. Fill Out Survey in your materials after the program we value your feedback.





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A History of Shaping Futures







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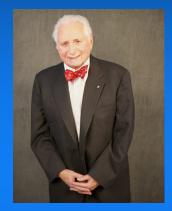
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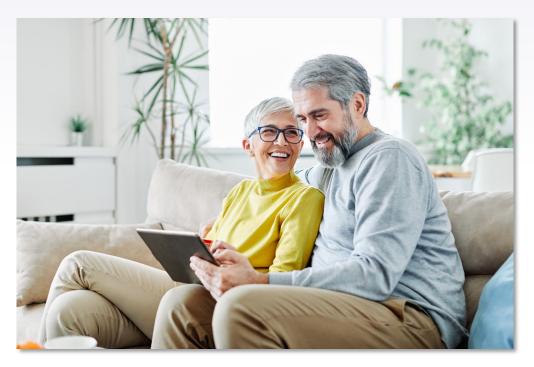




Kristin Peck

# Meet Greg and Naomi

- Live in Saratoga Springs home owned by Naomi
- Met through a Dating App 10 years ago.
   <u>Unmarried.</u>
- Both divorced with four children between them, ages 20-27
- No estate, financial or retirement plan.
   Outdated wills. Very little insurance.



Naomi, 59 and Greg, 56

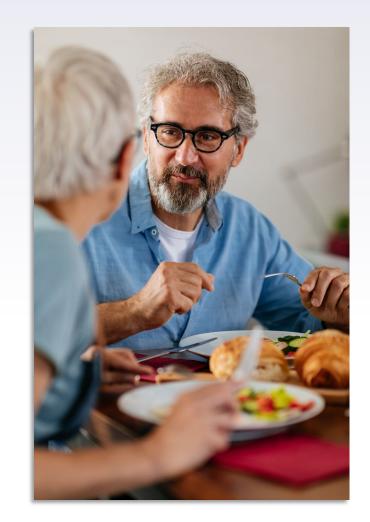


## Careers: A Financial Disparity

#### GREG

INTERGEN

- Greg is a civil engineer, NYS Department of Transportation
- Steady income
- Deferred comp retirement plan





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# Careers: A Financial Disparity

#### NAOMI

- Naomi has considerable assets
- BS in Computer Science from NYU and MS in Computer Engineering at Rensselaer
- Runs a thriving Internet-based company





# Naomi's Business



- Founded 6 years ago
- Minority and Women-Owned Business
   Enterprise grant (MWBE)
- Sells online games
- PPP Loan taken in 2020 \$1 million
- \$1M held as "excess" working capital





### Business Growth Potential



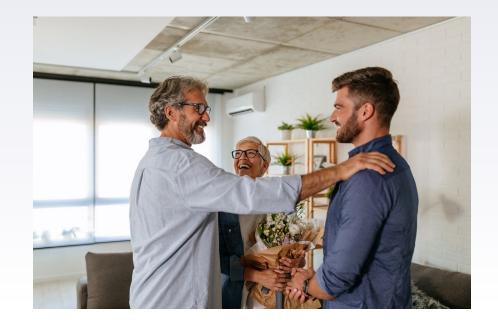
- Naomi has been approached by two private equity firms in the past six months
- Received indication of interest letters from both
- No intent to sell the business in the near future





## The "Kids"

- Naomi has a son Jason, 27, and daughter Julie, 25
- Greg has a son Thomas, 22 and Daughter Sara, 20





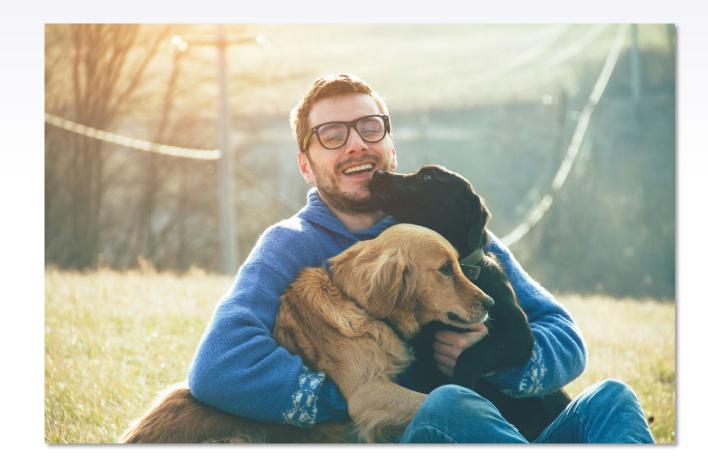
# Greg's Son, Thomas (22)

- Thomas attended a "Bring Your Son (stepson) to Work Day" at age 12 and became enthralled with video gaming
- Thomas has interest in the business and has management potential (None of the other children have expressed interest)



# Naomi's Son, Jason (27)

 Jason is on the autism spectrum and receives SSI and Medicaid which pays for the group home in which he resides





## Greg & Naomi's Parents



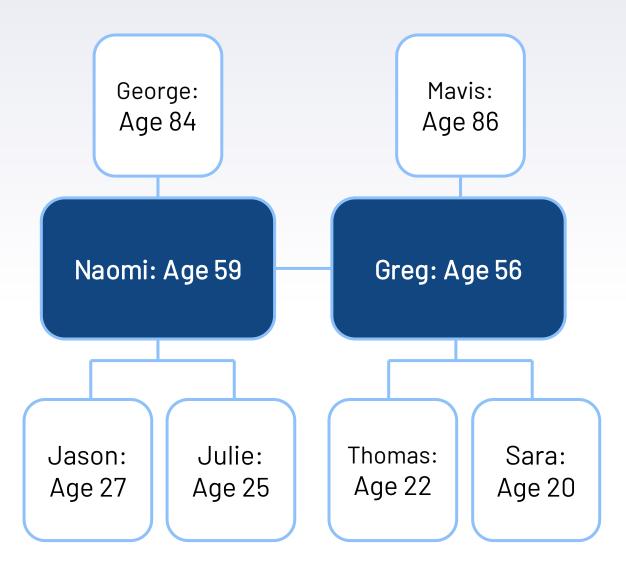
#### Naomi's Father, George

- 84 Years Old
- Excellent Health
- Successful Engineer Career
- Net Worth \$4.5 Million



#### Greg's Mother, Mavis

- 86 Years Old
- Declining Health
- In Need of Home Aides
- Home Valued \$225,000
- Other Assets: \$175,000
- Income: \$1,250/month





## Asset Overview: Naomi/Greg

### INCOME

- Naomi \$1 Million
- Greg \$120,000





## Asset Overview

#### NAOMI

- Saratoga Springs Home
- \$2MM (Mortgage \$500K)
- Phantom's Nest LLC (Sole Owner) \$13MM (2019 value)
- Liquid Assets (Investments/Cash) \$800K
- Life Ins. (Whole Life)
- Life Ins. (20 yr. term, 2015 purchase)
- IRA (Managed by TD Wealth)

\$500K (Cash Val. \$80K)

\$1MM

\$2.5MM





## Asset Overview

#### **GREG**

- Deferred Comp
- Condo in VT Near Stratton
- Liquid Assets (Investments/Cash)
- \$750K \$475,000 \$150K





# Greg & Naomi Planning Concerns:

- Unsure of how much Naomi's business is worth
- Worried about the economy and pandemic impact
- Worried about tax changes under the Biden Administration
- Concerned about their lack of retirement and estate plan



# Naomi & Greg's Goals

- Come up with a Plan and build a team to carry it out
- Maximize wealth, minimize tax and risk
- Secure financial future
- Create business succession plan for Naomi
- Provide for Mavis and Jason
- Create a legacy for future generations



#### **INTERGEN**

# Greg & Naomi Have Hired Our Team Of Advisors

- What are the planning considerations for the Greg and Naomi?
- How will our team meet these goals and provide for multigenerations of the family?



## AND IN VIEW OF ALL OPPORTUNITIES AT HAND, THIS COUPLE ALSO WANTS TO KNOW: **SHOULD THEY GET MARRIED?**





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A History of Shaping Futures

# Tax Planning for Phantom's Nest

Kevin O'Leary, CPA, Managing Director Kristin LeBrou, EA, CFP, Tax Manager Marvin and Company, P.C.





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#### Tax Planning for Individuals and Businesses



Kevin P. O'Leary, CPA Managing Director



Kristin LeBrou, EA, CFP® Tax Manager

INTERGENERATIONAL ESTATE PLANNING CONFERENCE NOVEMBER 19, 2021

**INTERGENERATIONAL ESTATE PLANNING CONFERENCE** 

### What's most important?!?

### **Communication and Education**



### **Business planning**

- Entity selection
- Risk acceptance
- What is your end game?

**INTERGENERATIONAL ESTATE PLANNING CONFERENCE** 

### Under the radar changes

- Changes to 163j
- Bonus depreciation
- Loss limitations under 461i
- NOL changes and limitations
- Leasing standard (f/s)



### **Original Tax Proposals**

- Extension of child tax credit increase
- Increasing top individual rate to 39.6%
- Increasing top capital gains rate to 25%
- Applying 3.8% NIIT to high-income S Corp owners
- Surtax on ultra-high-income taxpayers (\$5M)
- Cap on maximum QBI deduction
- Prohibition on Roth conversions of after-tax dollars
- Roth conversion prohibition for high income taxpayers



### **Original Tax Proposals**

- New RMD requirements for high income/high balances (\$10M)
- Wash sale rules to apply to additional asset types
- Reduction of unified credit
- Elimination of valuation discounts for nonbusiness partnership assets
- Elimination of benefits of intentionally defective grantor trusts

### What's In

- Extension of child tax credit increase
- Expansion of wash sale rules to digital assets, foreign currencies, commodities
- IRC 1202 (qualified small bus stock) gain exclusion limited to 50% for taxpayers with AGI > \$400K

### What's In

- Expand the 3.8% Net Investment Income Tax on active business income over \$400,000 (single) or \$500,000 (joint)
- Income tax surcharge for very high earners
  - 5% if MAGI > \$10 million
  - 3% add'l if MAGI > \$25 million
  - \$200,000/\$500,000 trust thresholds
- SALT cap increase to \$80,000 for 2021-2030

### What's In

- 15% minimum corporate tax on public corporations (over \$1B income)
- Limitations on excess businesses loss would be permanent (put on hold under CARES Act)
- 15% global minimum tax (and other foreign/GILTI changes)
- 1% excise tax on value of stock repurchases

### This Week's Tax Update

# Bipartisan Infrastructure Investment and Jobs Act (signed 11/15/21)

- Termination of Employee Retention Tax Credit (ERTC) for most companies
- Broker requirement to report digital asset transfers (for statements required to be filed after 12/31/23)

### **Estate Tax**

- Even if current Congress does not change estate exemption, slated to revert 1/1/26
  - Will increase between now and then

- Consider transferring LLC to trust now?
  - Take advantage of high exemption
  - Valuation discounts
  - No clawback

### **Grantor Trusts**

#### • Build Back Better Act originally proposed

- Estate tax inclusion for all defective grantor trusts
- Distributions from grantor trusts would be taxable gifts
- Taxable gift at time grantor trust becomes a non-grantor trust
- Gain recognition for transfers between grantor and grantor trust
- Even for pre-existing grantor trusts
- October 28, 2021 version includes none of this

### Why Grantor Trusts?

- Advantages at individual tax level
- Lower overall tax
- Easier to utilize large charitable deductions
- Removes asset from taxable estate
  - Plus taxes paid by individual on "trust's" income further reduces estate while retaining value of trust

#### **Grantor vs. Non-Grantor Trust Tax Brackets**

Sing	gle		
\$	-	\$ 9,950	10%
\$	9 <i>,</i> 950	\$ 40,525	12%
\$	40,525	\$ 86,375	22%
\$	86,375	\$ 164,925	24%
\$	164,925	\$ 209,425	32%
\$	209,425	\$ 523,600	35%
\$	523 <i>,</i> 600		37%
Capital Gains			
\$	-	\$ 40,400	0%
\$	40,400	\$ 445,850	15%
\$	445,850		20%

Trus	ts		
\$	-	\$ 2,650	10%
\$	2,650	\$ 9,550	24%
\$	9 <i>,</i> 550	\$ 13,250	35%
\$	13,250		<mark>37%</mark>
Capital Gains			
	-	2,700	0%
	2,700	13,250	15%
	13,250		20%

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#### **Grantor vs. Non-Grantor Trust**

Phantoms Nest income	e \$	1,000,000		
QBI Deduction	\$	(200,000)		
Net Business Income	\$	800,000		
Taxed to Grantor			Taxable Trust	
First \$523,600	\$	157,804	First \$13,250	\$ 3,146
Remaining income	\$	102,268	<b>Remaining income</b>	\$ 291,172
	\$	260,072		\$ 294,318

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#### **Other Tax Planning Thoughts**

- Charitable contributions
  - For 2021, 100% AGI limit for cash contributions
  - Cannot be to DAF
- Roth conversions
  - Although rates are not going up as expected, may still be desirable for certain clients

#### Do they get married?

- Most married taxpayers with disparate incomes save on income taxes
- Spousal rules for inherited IRAs
- Can also gift unlimited amounts to spouse if makes sense for estate planning
- Spousal Lifetime Access Trusts (SLATs)
- Estate tax DSUE
  - But does not apply for NYS





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#### INTERGENERATIONAL ESTATE PLANNING CONFERENCE



# Corporate & Estate Planning for Phantom's Nest

Louis W. Pierro, Esq., Founding Partner Pierro, Connor & Strauss, LLC



### Phantom's Nest LLC



- Wholly owned LLC taxed as a disregarded entity
- WBE Certification from NYS ESD
  - Navy contract early in Company history
  - Commercial gaming contracts are now larger part of Company revenue
    - Allows for consideration of larger pool of potential buyers



### Potential Buyers

- Private Equity Firms
  - Naomi wants to retain value and continue working
- Thomas (Step-Son)
  - On management track
  - Recapitalize LLC to allow for purchase of small portion of Company by Thomas
  - Establish a plan to incentivize Thomas





### Reorganization of Phantom's Nest LLC

- Recapitalization of LLC Units
  - Change capital structure of an entity to separate incidents of ownership (i.e. voting rights)
  - Operating Agreement is amended to include
     2% voting and 98% non-voting interests
  - Amendment to Articles of Organization to create manager managed LLC and appoint Naomi manager until retirement





### New LLC Interests

- Naomi owns 100% of Phantom's Nest so 100% of new interests will be initially owned by Naomi
- Naomi continues to hold 2% voting interest
- What are Naomi's options for the 98% Non-Voting?
  - Gift it to trust lose control and access
  - Sell it to trust keep control and access





### Sale of 98% Non-Voting Interests

- Non-voting interests are sold to Naomi's BDIT
  - BDIT is a grantor trust which preserves WBE status
  - Selling non-voting interests to trust allows for value transfer to children (more later)
  - Future sale from BDIT can occur with profit paid to Trust – benefits Naomi and eventually benefits her children





## Create Equity Appreciation Rights Plan

- Thomas is a participant in the EAR plan
- Upon a future trigger date (i.e. 10 years, sale of Company, etc.) Thomas can use credit in EAR plan to purchase a portion of the voting units of Phantom's Nest
- Can include other management employees in the EAR if desired



### Operating Agreement and EAR



- At the time of purchase of Units by Thomas
- Include buy-sell provisions to ensure no one outside family or employees can own units
- Preserve wealth transfer to children



### 2021 Estate and Gift Tax

- Federal 2021 Gift, Estate and GST Tax Exemption
  - \$11,700,000 per person
  - Sunset 12/31/25 > reduction to \$5,000,000)
- NYS Estate Tax Exemption = \$5.93 MM
  - No Gift or GST Tax in NY opportunity for large gifts
  - However, gifts made within 3 years of death are included. Strong motive to gift early, but how?
  - No State Portability





### State Tax Law

- A "Cliff" applies at 1.05% of New York's \$5.93mil. exemption entire value of the estate is subject to tax
  - ► Tax on \$5,930,000 = **\$0.00**
  - ► Tax on \$6,226,500 = \$538,992!!!
  - Use marital, charitable deductions in drafting to avoid the cliff
- 3 Year throwback rule gifts within 3 years of death are included in estate



#### Combined Federal & New York State Income Taxes

#### Maximum Income Tax Rate

- ► Federal: 37%
- ► NYS: 9.65 10.90% (2021)
- ► NYC: 3.6%

INTERGEN

- Net Investment Inc. Tax: 3.8%
- Combined: 55.3% NYC

51.7% Upstate

Federal Sunset 12/31/25 = 39.6%

#### Maximum Capital Gains Tax Rate

- Federal: 20% (28% on collectibles)
- NYS: 9.65%-10.90% (2021)
- ► NYC: 3.6%
- Net Investment Inc. Tax: 3.8%
- Combined: 38.3% NYC

34.7% Upstate

#### \$11.70 Million Gift and Estate Tax Exemption \$23.40 Million for Married Couples

#### **REASONS TO USE IT NOW:**

- 1. Reduction to \$5 mil. (adjusted) in 2025 or before
- 2. Remove future appreciation
- 3. Utilize Grantor Trust "Burn"
- 4. Historically low interest rates (GRAT's, Note Sales)
- 5. FLP/LLC Discounts may be disallowed
- 6. No portability of GST Exemption
- 7. No NYS Gift Tax, and 3-year clawback



#### **INTERGEN**

### Interest Rate Arbitrage

#### November 2021 Interest Rates

- Short Term AFR = .22%
- Mid Term AFR = 1.08%
- Long Term AFR = 1.85%
- **•** 7520 Rate = **1.4%**



### Tax Planning & Interest Rates

#### **Lower Rates Favor**

- GRATs
- Sales to IDGT
- CLATs
- Private Annuities
- Split-Dollar Life
   Insurance
- SLATs
- BDITs

#### **Higher Rates Favor**

- OPRTs
- GRITs
- CRATs
- Graegin Loans
- Farmland Alternative
   Valuation

#### **Generally Neutral**

- CRUTs
- CLUTs

INTERGEN

### Build Back Better Act

- Original bill would have eliminated many of the tools available to our clients
- Current version does not include the IRS "Green Book" provisions
- The Legislation is not final and the provisions could be added back
- Trump Tax Cuts sunset December 31, 2025



#### Intentionally Defective Grantor Trust (IDGT) Sale

- An IDGT uses is a transaction whereby a grantor gifts or sells a highlyappreciating asset to the Trust. (Sale is in exchange for a note)
- Trust as Obligor Seed trust w/ 10% or Personal Guarantees from beneficiaries
- Growth on the assets gifted or sold at discounted rates to the IDGT pass on to the trust beneficiaries free of any gift, estate and/or GST tax.



#### Intentionally Defective Grantor Trust (IDGT) Sale



- No capital gains tax is due on the sale to the trust because the trust is "defective" for income tax purposes.
- Interest income on installment note is not taxable to the grantor because the trust is "defective" for income tax purposes.
- The "Burn" occurs because the Grantor continues to pay tax on any income or gains from assets growing inside the IDGT.



### Structuring the Trust

#### The Delaware Self-Settled Directed Trust

- Current asset protection
- Multi-Generational Estate Tax Protection Dynasty Provisions
- Client can be added as beneficiary if necessary
- Client can continue to manage assets through an LLC
- Retain family control



### Delaware Directed Trust

**Administrative Trustee** 

Delaware Trust Company/ Corporate Trustee Investment Direction Advisor Investment Decisions Over Trust Assets

Distribution Advisor Power to Direct, Consent to, or Disapprove Discretionary Distributions

Trust Protector Power to remove and appoint trustee, trust advisor; modify or amend trust and modify terms of a power of appointment



### **Trust Protectors**

- Increasing Acceptance of Trust Protectors
- Irrevocable isn't so irrevocable anymore
- Avoid trust company interference in family business
- Adjust for future tax law changes
- Avoid loss of basis step-up
- Reduces Restrictions on Plan



#### INTERGEN

#### Spousal Lifetime Access Trust (SLAT's) (same rules as IDGT's)

- If Naomi and Greg get married she can gift a portion of the business to him
- Greg and Naomi could then create IDGT's, and name each other as beneficiaries – i.e. SLAT's
- All the same benefits as an IDGT, but access to trust income and principal by each spouse.



### Spousal Lifetime Access Trust (SLAT's)

- Use current \$11.7 million Gift and GST exemptions of each spouse
- Remove assets for NYS estate tax (3-year rule)
- Gift & note sale to IDGT
- Family "Dynasty" Trusts- In perpetuity
- FULL CONTROL AND ACCESS TO FUNDS DURING SPOUSE'S LIFETIME





#### Beneficiary Defective Inheritor's Trust ("BDIT")

- Leverages the benefits of an Irrevocable Delaware
   Trust while maintaining control and access for Naomi
- BDIT assets are protected from creditors and are not subject to estate, gift or generation-skipping transfer taxes for any future generations while the assets remain in trust
- Major difference Naomi is a Trustee and Beneficiary





### BDIT – Structure

- BDIT is established by a parent, grandparent, friend (any third party) with a \$5,000 gift to the trust
- No other gifts are made to the BDIT after this initial contribution
- Primary beneficiary is the business owner (Naomi) who is given the power to withdraw initial \$5,000 contribution
- Existence of withdrawal power causes BDIT income to be taxed to Naomi (grantor for income tax purposes). IRC 678.

#### **INTERGEN**

### Unique Advantages of a BDIT

- Feel the "Burn" Income taxed to beneficiary business owner (Naomi) rather than the trust, reducing her taxable estate
- Naomi can utilize trust assets and <u>control investments</u> as **Investment Adviser** (excluding life insurance)
- Naomi can <u>control distributions</u> of trust assets as **Distribution Adviser** if limited to an ascertainable (HEMS) standard (not cash value of life insurance)
- An Independent Trustee provides continuity and full administrative support can distribute for any purpose.



### Unique Advantages of BDIT

- Naomi can have a limited power of appointment over trust assets (not life insurance) to name the ultimate beneficiaries
- Interest payments to Naomi on promissory note from sale of business are not taxable because Naomi is considered the grantor of BDIT for tax purposes



### Unique Advantages of BDIT (continued)

- BDIT can pay for multiple life insurance policies because the trust owns a business generating significant cash flow
- No annual gifts to BDIT = no need to file annual gift tax returns or send Crummey letters (as required for typical ILIT)
- Naomi can <u>indirectly</u> access cash value of life insurance policy through an independent Delaware Trustee





### Unique Advantages of BDIT (continued)

- Estate Tax "Freeze" Sale of business removes all future appreciation of the business from Naomi's estate and for <u>all</u> future generations
- Does not require use of Naomi's GST exemption business was sold not gifted to BDIT





- Retain Control and Use of Assets
- Enhanced Asset Protection
- All Future Growth protected from Estate Tax, Creditors
- Tax on trust income paid by the Grantor the Burn
- Multi-generational Tax, Divorce and Lawsuit Protection for Children & Grandchildren

#### Question – What happens to the Promissory Note?



## THANK YOU!

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#### Mark Hasenauer, Wealth Strategist

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#### **Establishing Objectives**



- Financial security.
- Wealth transfer to their children.
- Tax savings.
- Asset protection for next generation.
- Create a legacy.

#### **Liquidity Considerations**



- What do Naomi and Greg want or need in terms of liquidity and cash flow during life?
  - What does life look like after selling Phantom's Nest, LLC?
- What are the long-term plans/needs for Jason?
  - Should he remain in the existing group home?
  - What are the current and future costs that need to be planned for?
- What liquidity is needed for their respective/combined family?
  - Are there specific needs/wants for the other children?
  - What is expected in terms of long-term care costs of Mavis?
- What liquidity is needed to continue to run the business?
  - Would the business suffer from business interruption or loss of value?

#### **Creating A Financial Plan**



- What assets do Naomi and Greg have now that will contribute toward their financial goals?
- How will they contribute to those assets over time?
- When will they need to access those assets?
- What are their financial goals from which they will draw upon those assets?
- How long will those assets need to last?
- Incorporating a Monte Carlo Analysis.

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#### **Creating A Financial Plan Continued**



- As a couple:
  - 13MM business (which is growing).
  - \$1MM in excess cash sitting inside the business.
  - \$3.25MM collectively in qualified plan assets and deferred compensation.
  - \$1MM in cash and non-qualified investments.
  - \$2MM of equity in real estate.

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#### **Creating A Financial Plan Continued**



- High level considerations for Naomi and Greg as a couple:
  - What can they spend as a couple and does this line up with their expectations?
  - How much does Naomi want to leave her children?
  - How much does Greg want to leave his children?
  - What happens if Greg and Naomi split up (or Naomi predeceases Greg).

#### **Creating A Financial Plan Continued**



- High level considerations for Greg:
  - \$750k in pension assets.
  - \$150k in savings.
  - Condo in Vermont worth \$475,000.
  - What can Greg spend and does this line up with his expectations?

#### **Creating An Action Plan**



- What kind of lifestyle do they want their assets to provide for them and their children.
- Coordinating their asset allocation based on their risk profile and the return they need to generate to meet their goals.
- Making sure that any estate plan will work with the goals that they put in place for each other and their respective children.
  - Crystalize estate planning objectives.
  - Confirm current plan lines up with their objectives.
  - Review available options based on all we know.
- Periodically updating the financial plan.

#### **Capabilities of Trusts**



Incorporating Trusts in Estate Plan:

- -Method to carry out family goals/legacy.
- -Centralized investment management.
- -Protection of funds from beneficiary's creditors (including divorce).
- Potential to maintain beneficiary's qualification for government assistance and benefits.
- -Potential exclusion of funds from beneficiary's taxable estate.
- -Efficient use of GST tax exemption.

#### **Capabilities of Delaware Trusts**



■ No rules against perpetuities (except for real estate).

- Directed trusts for flexibility and control (for investments and/or distributions).
- Confidentiality via quiet trusts.
- Potential for state income tax savings.
- Trust-friendly and experienced court system.
- Trust protectors.

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# Life Insurance Planning- What We Know

- The SECURE Act went into effect January 1, 2020
   Impact on inherited IRAs
- IRS Code Section 7702 updates go into effect on January 1, 2022
   Changes to internal rates of life insurance policies to reflect current interest rates
  - New limits on maximum contributions
  - $\circ$  New pricing schedules
- Tax Cuts and Jobs Act tax rates scheduled to sunset in 2026
   Federal estate tax limits

# Life Insurance Planning- What We Don't Know

- Changes to the step-up in basis at death for investments?
- Further (sooner?) changes to estate tax rates, exemptions?
- Increased capital gains tax rates?
- Removing the Roth conversion for high income individuals?
- Elimination of family discount for transferring fractional interests of closely held businesses?

- How to maximize Greg's New York State pension to provide both retirement income for him, and protection for his loved ones?
  - The Problem: If Greg takes the single life option (i.e. highest paying) on his pension, he leaves nothing behind if he passes away early. If he takes a survivor option, he'll leave income behind, but have less during his lifetime.
  - Naomi will probably be fine, but Greg may want to make sure Mavis is taken care of. Naming her as his beneficiary could impact her eligibility for other benefits, such as Medicaid.

- What is their net worth now, and what will it be in the future?
  - o Current Net worth:
    - Naomi: \$16.8M
    - Greg: \$2.6M
  - Net Worth in 2026 (assuming 5% growth rate)
    - Naomi: \$20.4M
    - Greg: \$3.35M

• The current federal estate tax exemption limit is set to sunset in 2026

- Current exemption: \$11.7M per person
- 2026 exemption: \$6.5M per person, after adjustments for inflation
- Additionally, New York State imposes an estate tax on estates valued over \$5.93M.
- **The Problem:** while Greg and Naomi's net worth continues to grow, the estate tax exemptions will be shrinking, creating an increasingly greater potential estate tax issue.

- Issues that unmarried couples face in retirement and estate planning:
  - Federal estate tax exemptions are not portable for unmarried couples.
  - How to balance estate equality in order to leave the right assets to the right people in the right amounts?
    - The default inheritance rules may not be sufficient, and outdated wills may not reflect Naomi and Greg's current wishes.
    - Some assets may not be easy to divide (real estate, business interests, etc).

**Issues that unmarried couples face in retirement and estate planning:** 

 The New York State Pension System allows for naming a non-spouse as an income beneficiary, but benefits will be fixed, and will not increase with inflation.

• The impact of the SECURE Act on inherited retirement accounts

- Addressing Jason's special needs
  - The Problem: Jason's SSI and Medicaid benefits can be reduced if he earns too much money or if he has too many assets in his name. He also may not be able to properly manage his own finances.

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- Employee Benefits Planning
  - The Problem: rewarding and retaining employees is becoming a greater concern to the success of small businesses. In a tight job market, employee perks are quickly becoming a differentiator to prospective candidates.

Group Life, Disability, and Long-Term Care

#### **Employee Benefits Planning**

- Rewarding and retaining key employees
- Executive Compensation Plans
- The New York Secure Choice Savings Plan (signed into law October 21, 2021), will require businesses with 10 or more employees to either provide a retirement plan, or sign employees up for state provided retirement accounts. Details are still forthcoming.

#### Business Succession

- **The Problem**: How does Naomi leave her business and pass the value of her business to her children when she dies in an efficient manner?
- If Thomas wants to become the eventual owner, how does he buy her out (as soon as six years from now)?
- If Naomi passes away prior to retiring, how does the full value of the business pass to Jason and Julie?
  - Avoid a "fire sale."
  - Neither child is interested in taking over the business, and Jason may not be capable, regardless.

#### **Insurance Basics and Considerations**

- Disability Income Insurance
- Long Term Care Insurance

   Standalone policies
   Hybrid life/LTC policies

• Annuities

### **Insurance Basics and Considerations**

#### • Life Insurance

Term versus Permanent

- Types of permanent:
  - Universal Life
    - Variable Universal Life
    - Indexed Universal Life
    - Secondary Guarantees
  - Whole Life

Stock versus mutual companies

#### • Life insurance on Greg

o Maximize his pension.

- o Assets left to care for Mavis, if needed.
- Life insurance on Greg and Naomi for SECURE Act considerations.
  - o Greg and Naomi each have retirement accounts worth \$2M or more.
  - This should be some form of permanent coverage.
    - Whole on Greg.
    - Universal on Naomi because of premium flexibility.

- Life insurance on Naomi, owned by Thomas, so that he can buy her estate out of the business, if she passes away.
  - Term or Permanent.
    - Term would be the inexpensive solution, but it would only address Naomi passing away.
    - Permanent life insurance would allow Thomas to begin building a taxfavored source of cash that could also be used to support a buyout at Naomi's retirement.
  - There should also be an agreement in writing that sets that sales price and binds both parties to the sale.

• Life Insurance on Naomi for Estate Planning

 Naomi's estate tax bill in 2026 could be over \$5.5M, based on Naomi's assets growing at 5% and current estate tax rates.

#### • Trust planning ideas:

• Irrevocable Life Insurance Trust (ILIT) for estate planning.

- This will keep life insurance proceeds out of the final estate, and potentially hold assets to remove them from the final estate.
- The trust can pay the life insurance premium using its own assets or income, or Naomi can make annual gifts to pay the premium.
- Having a trustee oversee the life insurance policy and trust assets can help avoid issues with Naomi's own capacity later in life.

- Trust planning ideas (continued):
  - Special Needs Trust (SNT) for Jason in order to leave assets for his needs, without endangering his SSI and Medicaid benefits.
    - This trust can own a life insurance policy on Naomi in order to be funded after Naomi is gone.
    - This trust can also hold and manage assets for Jason's benefit today.

#### • Trust planning ideas (continued):

• Beneficiary Defective Inheritor's Trust (BDIT)

- George or Greg could make a gift to a trust where Naomi is a trustee and beneficiary. The trust then buys assets from Naomi in exchange for a promissory note.
- To the extent that property sold to the trust is producing more income than needed to make interest payments, the excess income can be used to pay life insurance premiums on Naomi.

- Trust planning ideas (continued):
  - Moving assets to a trust now leverages the higher current estate exemption limits and allows for more assets to moved without gift taxes being due than if Naomi waited.

# **Interesting Cases**

- Dennis, New York City business owner
- Tom and Jane, unmarried, early 60s



# Business Valuation for Phantom's Nest

Chuck Coyne, Senior Managing Director, Empire Valuation Consultants



# Phantom's Nest ("PN")

- Given her wishes, what are Naomi's options?
- Strong options:
  - #1| Sell the 98 non-voting units to the trust, now!
  - #2| Recapitalize units (voting and non-voting)
  - #3| Distribute excess cash to herself (more later..)
- #1| Why now to get a valuation for sale to the trust?
  - a. PN is still relatively small

- b. The "payday" can wait as Naomi to retain PN for 5 years, then exit (sell to PE, employees, or "step" son).

Valuing now allows lower firm value & higher discount for lack of marketability ("DLOM"), which help as sale locks in the value (any appreciation outside her estate).

# How to arrive at PN's firm value?

- Income approach (MORE LIKELY)
  - Outlining appropriate cash flows to discount (based upon projected income statements and balance sheets for PN). Note, PN's forecast would show lots of growth.

- This followed by selecting an appropriate discount rate for projections. Likely to be a high discount rate given "early-stage" risks of PN.

Market approach (LESS LIKELY)

- Select guideline companies (or transactions). More relevant would be transactions (PN is smaller than most public firms).

- Prior proposed transaction (e.g., indication of interest) would have less weight if buyers were strategic in nature.

#### **Factors that drive the DLOM**

PN is currently small:

- All else equal, a minority stake in PN with \$13 million in sales supports a DLOM 5% higher than bigger firms (based on medians from study data).

PN is not being sold soon:

- PN has a bigger DLOM now given Naomi's plan to wait for her exit (and potential third party/external sale) until 2025 (when she is 64 or 65).

Bottom line PN is <u>growing</u>. Good time to sell the non-voting units to the trust before firm value skyrockets.

#### **Recapitalizing Units – ins & outs**

- What does this mean?
  - Set up two classes of units
  - Typically, 98% non-voting and 2% voting
  - The 2% can vote (e.g., ability to control management)
- Voting and non-voting summary for valuation:
  - Allows an incremental discount (for non-vote status)
  - This discount is 5% +/- (a premium for voting)
  - Allows the bulk of PN's economic value to go to the trust and still have this interest that is sold benefit from valuation discounts.

### **Distributing the \$1 million**

- Why is this a option worth considering?
  - Removes a non-operating asset before the valuation (will reduce the value of PN in the appraisal).
  - Allows for other wealth transfer strategies (ones that benefit from valuation discounts).
- What would happen to Naomi's personal balance sheet?
  - Currently \$800k in discretionary/liquid.
  - Once PN's cash is out, Naomi will have \$1,800k liquid.

#### Naomi's personal assets

- With Naomi's wishes, what are potential options for her?
- Place some of her \$1,800k liquid to an LLC\*
- Use the LLC as a wealth transfer vehicle to benefit Jason and Julie.

\* Investment holding company that is an LLC (could also be family limited partnership). This vehicle would likely be separate from the trust, which is to hold the 98 non-voting units in PN.

### How to arrive at the LLC's firm value?

Asset approach (MOST LIKELY)

-Adjusted Book Value Method focuses on individual asset values (e.g., potentially \$700k in stocks & \$700k in bonds).

- Assuming stocks & bonds in LLC, these would be at fair market values in the statements provided by the wealth manager.

- Discounts by asset class other items held by Naomi:
  - Bonds or dividend paying preferred lower
  - Public Equities potentially larger discounts
  - Private equity LP interests higher discounts. May be an option to invest into with the \$1 million paid out.

### All-in LLC Discounts – Empire's view

- Discounts (both asset and the entity level DLOM):
  - Discounts combined (lack of control & marketability) are often 25% to 35% (even if/after latest HR 5376).

- Again, type of assets put into the LLC impact the discounts supportable.

- <u>Higher discounts at entity level are driven by:</u>
  - Less likelihood of distributions.
  - ownership rights, including information access.
  - ease or difficulty of sale/transfer.

### LLC Discounts – what could change?

- Nonbusiness assets eliminating valuation discounts:
  - The Ways and Means Committee's September 13 press release (Subtitle I) proposed amending Section 2031 to clarify *"that when a tax payer transfers nonbusiness assets, those assets should not be afforded a valuation discount for transfer tax purposes."*

- The October 3, 2021 version of HR 5376 retained this quote but by the 28<sup>th</sup> it had <u>GONE AWAY!</u>

- If this item comes back in.... the big impact is that <u>all</u> the discounts discussed for LLC <u>disappear.</u>

#### **Questions** ???

#### **Chuck Coyne, ASA**



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For over 30 years, Chuck has provided business valuations of privately held companies in various industries. He has prepared valuations for estate and gift tax, employee stock ownership plans (ESOPs), family business succession, bankruptcy and reorganizations, fairness opinions, marital dissolution, shareholder and partnership disputes, and mergers, acquisitions, and divestitures.

Chuck specializes in transactional consulting services including; assistance in business succession planning, mergers and acquisitions, ESOP feasibility and transaction structuring, ESOP transaction quarterbacking, assistance in obtaining financing, and other financial advisory related consulting services. Chuck has assisted companies with revenues of less than five million dollars to over half a billion dollars.

Chuck received his MBA with a concentration Accounting from University of Hartford. He holds a Senior Accredited Appraiser ("ASA") designation from the American Society of Appraisers. He serves as the immediate past Chair of the Valuation Advisory Committee of The ESOP Association and is a member of the National Center for Employee Ownership (NCEO). Chuck has also served as a Trustee for the Employee Ownership Foundation (EOF).





# Elder Law & Special Needs Planning Considerations

Aaron E. Connor, Esq., Managing Partner Pierro, Connor & Strauss, LLC



# Implementing the Business Plan and the Estate Plan

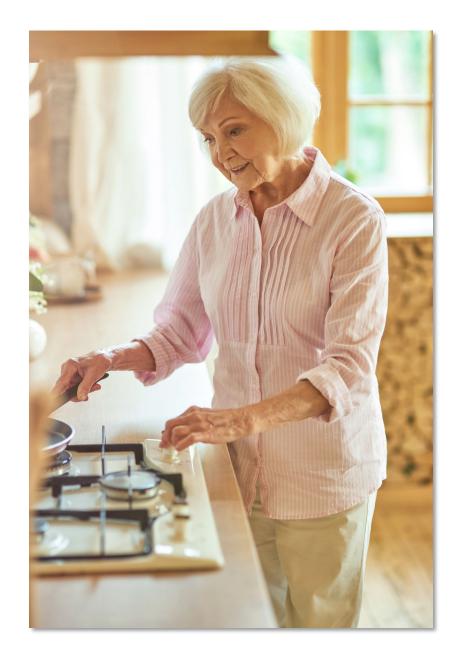
What If Naomi Becomes Seriously III or Incapacitated?

- Corporate governance structure must provide for appropriate succession and persons of authority
- Naomi needs properly drafted Advance Directives
  - Power of Attorney
  - Health Care Proxy
  - Health Care Declaration ("Living Will")
- Greg also needs these Advance Directives

#### INTERGEN

## Caring for the Older Generation

- Mavis is in failing health
- Financial and health care decision-making is needed
- Paying for her long-term care costs





# Can a Person with Diminished Capacity Engage in Advance Planning?

- Traditionally, physicians have tended to construe capacity as either present or absent
- Today, physicians use a <u>decision-specific approach</u>, whereby the measure of capacity is a person's <u>understanding of a specific decision or task</u>
- The level of capacity needed to perform a task or make a decision will vary depending on its complexity





# **Evaluating Capacity**



- Can Mavis participate and execute planning?
- Consider having a physician or psychologist do a capacity test since there is some doubt about whether Mavis can engage in advance planning
- If Naomi were to become ill, can she proceed her planning
- Consider the following guidelines developed by Peter J. Strauss based on current thinking, the rules of professional conduct for attorneys promulgated by the American Bar Association and the State of New York

#### **INTERGEN**

## Guidelines to Determine Who Can Execute Advance Directives

A person would be determined to have sufficient capacity to engage in advance planning or for management decisions if she or he:

- Is aware that she has <u>difficulty with decision making</u> for health care or managing day-to-day decisions at the present time or in the future
- The choice of a fiduciary to assist is reasonable



# Capacity Test (cont.)

- The choice is consistent with the history of prior choices and lifetime decisions
- Can articulate the reason underlying the need to establish a particular legal document
- Can appreciate the consequences of the execution of the legal document
- Important: the difference between Memory and Judgment





# Failure to Plan

- Without proper planning, decisions will need to be made by a court appointed guardian under Art. 17A or 81
- Upon the death of parent or family member, assets may pass outright to an individual with a disability and disrupt benefits
- If person with disability is designated as beneficiary of non-probate assets, government benefits (and the assets) may be lost due to restrictive Medicaid laws
- Control by a guardian of assets earmarked for an individual with disabilities may not be immediately available to pay for needed care
- Mavis' money might run out







## Options for Greg & Naomi to Cover LTC Costs

Private Pay

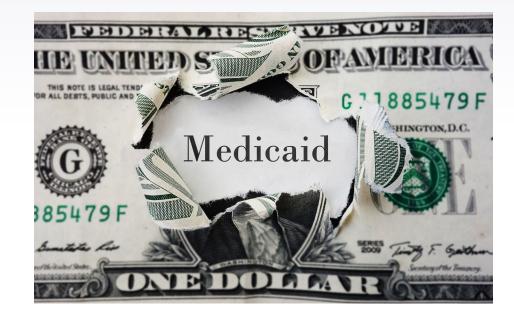
INTERGEN

- Long-Term Care Insurance purchased by Greg or Naomi (when Mavis was younger)
- Supplemental Needs Trust for Mavis, set up by Greg



## Options for Mavis to Cover Her Own Care

- Reverse Mortgage on her Schenectady Home
  - Equity \$225,000
- Obtain Medicaid Eligibility
- Create a Medicaid Asset Protection Trust
- Outright gifting to Greg?



How soon could Mavis be eligible for Medicaid? December 1, 2021!





# 2021 Medicaid Eligibility Numbers

Monthly Income	
Individual (at home)	\$884 (+\$20) <sup>1</sup>
Couple (both at home)	\$1,300 (+\$20) <sup>1</sup>
Minimum Monthly Maintenance Needs Allowance (MMMNA) <sup>2</sup>	\$3,259.50
Resources	
Individual	\$15,900
Couple (both at home)	\$23,400
Comm. Spouse ResourceAllowance	\$74,820 (or the spousal share of 1/2 combined resources up to a maximum of \$130,380)

I-The first \$20 of monthly income per household will not be counted when determining the eligibility of those Medicaid applicants who are aged, blind, or disabled. Income includes monies coming in each month such as Social Security, pension, rent payments, and disability payments 2 – If Community Spouse makes less than \$3,259.50 of their own income, they will receive a portion of their spouse's to reach \$3,259.50

#### INTERGEN

# Mavis' Legal Planning for Medicaid

- Income \$1,250/ Month
- Assets
  - Home \$225,000
  - Other Assets: \$175K
  - IRA
  - Stock
  - Savings & Checking





# Medicaid Home Care Example

- Step 1 Mavis creates and funds a Medicaid Asset Protection Trust with her home, stock and a portion of her cash assets
  - IRA is an exempt resource when in pay out status

Step 2 – Mavis creates a Pooled Trust and assigns \$346 of income per month (\$1,250 – \$904 allowed)





# Medicaid Home Care Example

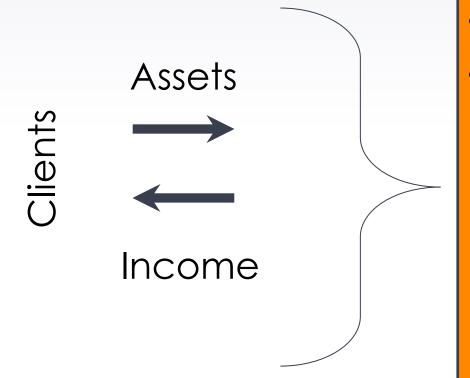
- Step 3 Mavis applies for Medicaid What is exempt?
  - IRA in payout status
  - Assets = \$15,900
  - Home (transferred to her trust)
  - Allowable Income = \$904



- Medicaid Trust and Pooled Trust funded- income and asset protected
- No Waiting Period Under Current Rules
  - New Transfer of Asset Penalty Rules for Community Medicaid in 2022

#### INTERGEN

# Medicaid Asset Protection Trust (MAPT)



Trustee – manages trust assets
Beneficiaries

Client – income for life and

right to use real property

Heirs = Remaindermen inherit when trust ends



## MAPT

- Home
- Bank Accounts
- Stocks & Bonds
- Annuities
- Life Insurance
- Business
- Real Estate

#### **Medicaid Asset Protection Trust**

- Income is yours if you want it
- Principal can NOT be given back to you directly, but
- Principal can be given to children or other beneficiaries



## **KEEP OUT**

Cash

Bank Acct.

IRA, 401(k)

### **Security Features**

- Choose initial Trustee, and change at any time
- Choose initial beneficiaries, and change at any time
- With the consent of all beneficiaries, in some jurisdictions the trust can be "amended or revoked"



# Providing for Jason's Needs with a Supplemental Needs Trust

- Jason is on the autism spectrum
- Purpose: support and enhance his quality of life by providing a supplemental source of funds
- Because of certain legal benefits of these trusts, Jason can remain eligible for government benefits that have income and resource tests such as his SSI and Medicaid





## Solution: Naomi Establishes a Third Party SNT

- Created for the benefit of Jason and funded by Naomi
- Properly drafted, the trust will not be considered an asset to Jason which would make him ineligible for Medicaid
- Trust assets may be used as the trust directs at the discretion of the trustee – flexible, easy to administer
- Must be a discretionary trust, not a support trust



# Advantages of Third-Party SNT

- NO PAYBACK REQUIREMENT
- Less stringent distribution rules than First-Party SNTs (such as the MAPT)
- Can be incorporated easily into existing planning
- Other relatives or friends may also want to contribute to the trust
- In such case, the creator may wish to establish the SNT during her or his lifetime
- It may be wise for divorced parents to set up the SNT during lifetime

#### **INTERGEN**

# Special Needs Persons and Sibling

- Jason's future needs may be unclear
- Determining what percentage of Naomi's assets Jason and his sibling will inherit is difficult
- Flexibility is necessary

INTERGEN

- Who makes the decision?
- Can the allocation decisions be defended?
- How is the decision made (guidelines)?
- Consider purchasing life insurance to fund share of Jason's needs



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# THANK YOU



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# Wrap Up and Questions





# **THANK YOU!**

Please complete the brief post-webinar Survey

See you next year for the

17<sup>th</sup> ANNUAL INTERGENERATIONAL ESTATE PLANNING CONFERENCE