

10 Practical Income, Gift, and Estate Planning Considerations

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TOPIC 1

Community & Separate Property



Sharing is caring...and may be beneficial.

- As taxpayers migrate across the US leaving their once home state due to:
 - Weather, Income Taxes, Excise Taxes, Estate Taxes
- With the proper planning, community property treatment can be maintained when moving to a separate property state (WA to Montana).
 - Tracing Assets, Joint Revocable Trusts, Community Property Agreements.
- Need to be mindful as to what is the status of a taxpayer's asset. Advantages for preserving community property include:
 - Double Basis Step-Up (1st to pass) – receive step-up on entire asset value.
 - Estate Tax Bracket Equalization – only tax 50% of exposed assets reported.
 - Generate minority discounts – undivided one-half interest.
- Funding SLATs:
 - Need to consider creating separate property.

TOPIC 2

Roth Conversions & Backdoor Roth IRAs

2

The Secure Act 2.0

- Previously, beneficiaries could generally step into the shoes of the decedent (Stretch IRA).
- Max payout period of IRA asset is now 10 years for most non-spousal beneficiaries (Other Designated Beneficiaries).
- Beginning in 2024, surviving spouse can be treated as IRA original owner and take RMDs over their life expectancy, or be the beneficiary of the IRA (inherited IRA).
- There could be benefit for younger spouses to be IRA owner, whereas older spouses may elect to be the IRA beneficiary.
- Roth does not require RMDs during original life-time.
- Consider opportunities for spouse who becomes IRA owner to convert traditional IRA into Roth IRA.
- Can roll over \$35k from 529 Plans to Roth IRA account – must have 529 for 15 years.
- Can now make one-time \$53k QCD to Charitable Gift Annuity or ~~Charitable Remainder Trust~~.

Roth IRAs

- Roth IRA Contribution Income Limits for single and married filing joint are \$146k-\$161k and \$230k-\$240k.
- 2024 Contribution Amount is \$7,000 (Backdoor Roth)
 - Can make IRA contributions for the prior year up until 4/15 – double up on non-deductible contributions.
 - Roll contributions over contributions tax free to Roth IRA (Backdoor Roth IRA).
 - All Traditional IRAs need to be considered – separate taxpayer.
 - Backdoor conversions remains to be a legislative target.
- Convert amounts now from your traditional IRA to your Roth IRA.
 - Poor candidate – using IRA funds to pay conversion tax.
 - Expectation is that tax rates today will be lower than rates in the future.
 - Beginning 2026, Top Tax Rates will reset to 39.6% from 37% absent legislative action.
 - Top tax rate is 37% for income over \$609k/\$731k.

TOPIC 3

Splitting IRAs to Charity & QCDs

3

IRAs and Charities

- IRAs are often great assets to use for charitable gift purposes to avoid ordinary income and not lose out on charitable (itemized deduction) mechanics.
- QCD limit for 2024 = \$105,000
- For Estate planning purposes – avoid the complications of directing large IRA accounts by splitting an existing IRA into two separate (or more) accounts:
 - Account #1 names the charity as the beneficiary. This account will also fund the annual QCDs while the owner is alive. At time of passing, remainder of IRA passes to charity. No net Estate tax – satisfies charitable intent.
 - Account #2 name the individual beneficiaries – asset would be pass to individuals at time of passing. Would be taxable to decedent's Estate.
 - Avoid 'group' from being subject to the lowest payout timeline (5 years versus 10 years).

TOPIC 4

Funding CRTs with IRAs



Let's stretch a little more...

- Traditional IRAs can be one of the more troublesome assets to inherit – subject to both an Estate tax and an income tax to the beneficiary.
- Using an IRA to fund a Charitable Remainder Trust allows the income recipient to bypass the 10-year pay-out rule and look to the pay-out period of the CRT instead.
- Example:
 - \$2M IRA to a 20 Year, 10% CRT
 - 7520 Rate 5.4% (May), 4% Growth and 5% Income
 - Current year deduction of \$243k
 - \$1.4M passes out to charity

Let's stretch a little more...

TAX RATE	FOR SINGLE FILERS	FOR MARRIED INDIVIDUALS FILING JOINT RETURNS	FOR HEADS OF HOUSEHOLD
10%	\$0 to \$11,600	\$0 to \$23,200	\$0 to \$16,550
12%	\$11,600 to \$47,150	\$23,200 to \$94,300	\$16,550 to \$63,100
22%	\$47,150 to \$100,525	\$94,300 to \$201,050	\$63,100 to \$100,500
24%	\$100,525 to \$191,950	\$201,050 to \$383,900	\$100,500 to \$191,950
32%	\$191,950 to \$243,725	\$383,900 to \$487,450	\$191,950 to \$243,700
35%	\$243,725 to \$609,350	\$487,450 to \$731,200	\$243,700 to \$609,350
37%	\$609,350 or more	\$731,200 or more	\$609,350 or more

- Adult Child Taxpayer has \$250k MFJ (24%)
- CRT pays \$200k + \$250k = 32% bracket.
- Permanently avoid ~5% (37% - 32%) on \$2M = \$100k federal tax.

TOPIC 5

Use of LLCs to Hold Out-of-State Real and Tangible Personal Property



Planning Opportunity: LLCs to Hold Out-of-State Real Property

- Estate planning should review location of assets to consider planning opportunities to mitigate estate tax liabilities to Oregon and other states.
- Oregon Residents and Nonresidents are subject to Oregon Estate Tax but differently.
- Oregon estate tax statutes apply a fractional formula (ORS 118.010) that can result in unexpected results for an OR nonresident.
- A WA resident will be subject to OR estate tax even if all OR located property was to pass to charity or to a surviving spouse.

	OREGON RESIDENT	OREGON NONRESIDENT (WA RESIDENT)
FILING REQUIREMENT	Worldwide Gross Estate of \$1,000,000 or more	Worldwide Gross Estate of \$1,000,000 or more + OR Real or Tangible Personal Property
FRACTIONAL FORMULA FOR OREGON ESTATE TAX	$\frac{\text{OR Real Estate} + \text{OR Tangible Personal Prop} + \text{All Intangible Prop}}{\text{Worldwide Assets}}$	$\frac{\text{OR Real Estate} + \text{OR Tangible Personal Prop}}{\text{Worldwide Assets}}$
TAX TRIGGERED IF	Worldwide Taxable Estate exceeds \$1,000,000	Worldwide Taxable Estate exceeds \$1,000,000 and includes OR Real or Tangible Personal Prop

2023 Form OR-706

Part 2—Tax computation

1. Total gross estate (from page 3, part 5, line 512)	• 1.	4,000,000.00
2. Total allowable deductions (from page 3, part 5, line 522)	• 2.	2,000,000.00
3. Natural resource property exemption (see instructions)	• 3.	.00
4. Taxable estate (line 1 minus lines 2 and 3, if applicable)	• 4.	2,000,000.00
5. Oregon estate tax (see instructions, part 6, for tax table)	• 5.	102,500.00
6. Gross value of property located in Oregon (see instructions)	• 6.	2,000,000.00
7. Oregon percentage (line 6 divided by line 1, round to four decimal places, no more than 100%)....	• 7.	50.00%
8. Tax payable to Oregon (line 5 multiplied by line 7)	• 8.	51,250.00

Example: WA Resident

- WA resident dies in 2024 with \$4 million gross estate consisting of \$2 million of real property located in WA and \$2 million in OR. She leaves WA real property to her children and OR real property to her spouse (eligible for the marital deduction).
- Since the fractional formula computes tax on the worldwide taxable estate in excess of \$1 million first, and then applies OR apportionment, OR estate tax of \$51,250 will be owed.

Planning Opportunity

- Place OR real property in an LLC (single member or multi-member), as Oregon treats a limited liability interest as an intangible asset (OAR 150-118-0010), like stocks, bonds, bank deposits, partnership interests.
- Intangible assets are not included in the numerator of the fractional formula and will avoid OR estate tax for a WA resident.



TOPIC 6

Excise Tax – Cost Basis for WA Capital Gain Purposes



WA Capital Gains Excise Tax

- **Pay WA capital gains excise tax in year of sale of capital assets to reduce capital gains**
- In March 2023, the Washington Supreme Court held that long-term capital gains (LTCG) tax on individuals constitutes a valid excise tax.
- It rejected Superior Court's holding that it was an income tax.
- The US Supreme Court refused to review the lawsuit challenging the WA capital gains tax.
- The Washington Supreme Court drew similarity and reference to Washington's real estate excise tax (REET), which is treated as a cost of sale that reduces amount realized and thereby federal capital gains.



WA Capital Gains Excise Tax

- Due to the Washington Supreme Court's holding and the US Supreme Court's decision not to review the case, many practitioners believe that there is a filing position for reporting the excise tax as a cost of sale.
- Like the REET, this new excise tax may reduce federal LTCG allocated to Washington, by treating it as a cost of sale.
- **Biggest benefit from reporting as an excise tax vs. income tax is that deduction is not limited by the current State and local income tax cap of \$10,000.**
- The due date of the Washington tax return to report the capital gains and pay tax is on or before the due date of the federal tax return (April 15).
- There could be a potential mismatch between the tax year in which capital gains are recognized and the tax year in which the excise tax on capital gains is paid.

Planning Opportunity

- Pay excise tax in the same year as when capital gains are recognized to be able to reduce capital gain income (or increase capital losses).
- For Example: WA excise tax on capital gains is \$1,000,000.
- Proper timing of payment crucial to avoid creating large capital losses in subsequent year with no offsetting capital gains available.



TOPIC 7

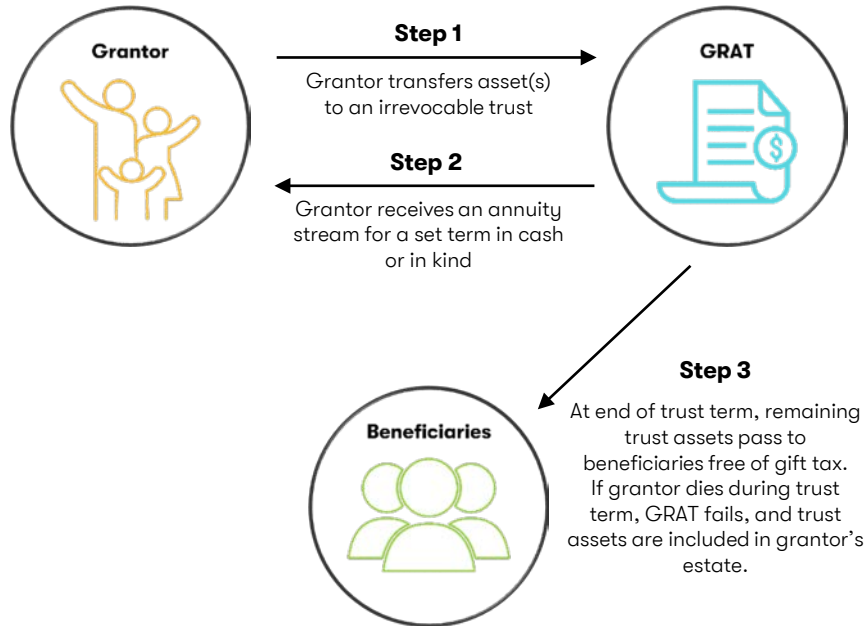
Estate Planning for Married Couples – Two Planning Concepts



Higher Inflation = Higher Exemptions

- For married couples who think they have fully utilized their exemptions, higher exemptions due to inflation adjustments present a great opportunity to make new gifts to family members free of transfer taxes.
- Use of gift tax annual exclusions of \$18,000 to any individual in 2024.

INFLATION ADJUSTMENTS	TRANSFER TAX EXEMPTION INCREASE	
	2024	2023
PER INDIVIDUAL	\$690,000	\$860,000
MARRIED COUPLE	\$1,380,000	\$1,720,000



How a Zeroed-Out GRAT Works, William Blair

GRATs are still an option

- While it is true that a GRAT is more appealing in a low interest rate environment, it can still be an effective wealth transfer technique in a rising interest rate environment.
- A longer term GRAT may make more sense.
- A GRAT's success or failure depends on whether the appreciation of assets transferred to the GRAT can beat the Sec. 7520 rate (May 2024 = 5.4%).
- The GRAT can be structured as a Zero'd out GRAT, which means that the transfer of assets to the GRAT does not use any of the couple's transfer tax exemption or result in any gift tax owed.

GRATs

- If the married couple own assets with significant growth potential, e.g., securities that are currently depressed but are expected to appreciate in the future sufficient to clear the Sec 7520 hurdle rate, they should consider implementing the GRAT strategy.
- Even if the GRAT fails (either due to a mortality risk or appreciation below Sec 7520 rate), there are no adverse tax or economic consequences other than the costs associated with the setup and administration of the GRAT.
- With uncertainty in the future of GRATs, from legislative proposals attempting to curtail the effectiveness of GRATs to inevitable increases in future interest rates, taxpayers who have been contemplating Zero'd out GRATs should consider acting sooner than later.

TOPIC 8

Use of Swap or Substitution Power in Irrevocable Grantor Trusts



E.g., Spousal Lifetime Access Trusts (SLATs)

- **Spousal lifetime access trust (SLAT)** - Taxable gift is made by settlor-spouse to an irrevocable trust for the benefit of the settlor's spouse and/or other family members (children/grandchildren).
- SLAT is an effective estate planning tool for married couples to utilize remaining higher exemption amounts, for one or both spouses, while still providing cash flow to the marital household.
- Inclusion of swap power or power to substitute (IRC § 675), can qualify the SLAT as a grantor trust for income tax purposes while still removing assets from grantor's taxable estate
 - It is the power to reacquire trust corpus by substituting other property of equivalent value.
 - The power is exercisable by the settlor-spouse in a nonfiduciary capacity, without the approval or consent of any person acting in a fiduciary capacity (trustee).
- Substitution or swap provision is a powerful tool that adds flexibility to an irrevocable trust for grantor's investment, income tax and estate planning:
 - E.g., swap equivalent cash for highly appreciated Apple stock held in the SLAT to preserve basis step-up through inclusion of the stock in the grantor's estate.
 - E.g., swap equivalent cash for family business interest transferred to SLAT to gift business interest to daughter who is now more active in the business than the son.

Spousal Lifetime Access Trusts (SLATs)

- IRS Revenue Ruling 2008-22 provides important guidance:
 - The use of substitution power should not result in the SLAT assets being included in the grantor's gross estate.
 - The trustee is under fiduciary obligation to ensure assets swapped/substituted are of equivalent value.
- Right to swap is not a taxable gift but consider reporting the swap on a gift tax return at zero value. If adequately disclosed, it will serve to toll the statute of limitations for a later IRS audit.
- In conclusion:
 - This useful tool is often forgotten after the trust instrument is signed and safely put away.
 - Basis step-up at grantor's death from assets swapped can be a valuable income tax opportunity to heirs by eliminating capital gains tax.
 - It is time to review the trust instrument to look for the power and the options for its application.

TOPIC 9

Case Study: Lifetime Gifting with Margin Loans



Case Study

- **Use of margin loans to reduce WA gross estate while preserving basis step-up in certain situations**
- **Facts**
 - Wealthy WA Resident (surviving spouse) not in good health; four children-beneficiaries
 - Children filing status: Married filing joint (MFJ)
 - 2024 projected long-term capital gains tax bracket: 23.8%
 - Assets: Consists mainly of Portfolios of Highly Appreciated Long-term Capital Gain Securities - \$6,000,000
- **Goals**
 - Preserve Basis Step-Up for heirs, without having to sell securities and incur tax on capital gains
 - Use lifetime gifting to reduce WA Taxable Estate to below WA estate tax exemption of \$2,193,000
- **Planning**
 - Secure margin loan with securities as collateral for \$4,000,000
 - FYI – Interest on Margin Loan not factored in calculations; payment of interest will further reduce WA Taxable Estate.
 - Engage in lifetime cash gifting to heirs from proceeds of Margin Loan \$4,000,000
 - Lifetime gifting should reduce WA taxable estate to below \$2,193,000

Case Study: Lifetime Gifting with Margin Loans

WASHINGTON RESIDENT	GROSS ASSETS	COST BASIS	BUILT-IN LONG-TERM CAP GAIN	MARGIN LOAN
FACTS:				
Original Portfolio of Appreciated Securities	6,000,000	(1,000,000)	5,000,000	
Margin Loan Proceeds	4,000,000			(4,000,000)
LIFETIME GIFTING USING MARGIN LOAN:				
Lifetime Cash Gifts to 4 children	(4,000,000)			
Gross Assets Prior to Death	6,000,000			
WA ESTATE TAX SAVINGS:				
WA Gross Estate at Death	6,000,000			
Debts of Decedent (Margin Loan)	(4,000,000)			
Tentative Taxable Estate	2,000,000			
WA State Applicable Exclusion	(2,193,000)			
WA Taxable Estate - NONE	-			
INCOME & EXCISE TAX SAVINGS TO HEIRS				
DUE TO BASIS STEP-UP:				
Federal Tax savings @ 24% on \$4,000,000 gifted			960,000	
WA Excise Tax savings @7% on \$4,000,000 gifted			280,000	
Approx. Federal Income & WA Excise Tax Savings			1,240,000	

TOPIC 10

Case Study: CRTs to Avoid Other State & WA Excise Tax

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Avoiding those pesky local or excise taxes

- CRUTs are a great tool for smoothing out income and providing cash flow. They can also be a great tool in avoiding some of our PNW taxes.
- Client (MFJ) owns low basis stock (intangible asset) targeted for acquisition – will generate \$50M of proceeds/gain. Client funds \$30M to a 20-year term CRUT, 10% pay-out. Assume 4% growth and 5% income on reinvested proceeds.
- Example 1 – Client is a WA Resident and funds a CRUT with stock pre-sale – sale occurs near year-end.
 - Client Receives \$10.75M charitable deduction – utilized fully with 5-year carryover (\$2,559M federal benefit)
 - CRUT Capital Gain in Year 1 + ~\$20M of capital gain.
 - Year 2 – 20, \$4,750,000 of income avoids 7% tax or saves ~\$333k in WA Excise Tax
 - Year 2 – 20, saves ~\$570k in federal capital gains taxes (15% versus 20% bracket).
 - Client receives \$20M (gross) in year 1 + \$43M from CRUT. Leaves \$61.4M to charity.

Avoiding those pesky local or excise taxes

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- Example 2 – Client is a WA Resident and funds a CRUT with stock pre-sale – sale occurs near year-end.
 - Client Receives \$10.75M charitable deduction – utilized fully with 5-year carryover
 - CRUT Capital Gain in Year 1 + ~\$20M of capital gain.
 - Year 2 – WA Excise Tax is abolished (or taxpayer moves to Nevada).
 - \$43M CRT distributions avoids WA Excise tax = \$3M
 - Client receives \$20M (gross) in year 1 + \$43M from CRUT. Leaves \$61.4M to charity.

Avoiding those pesky local or excise taxes

- Client (MFJ) owns low basis stock targeted for acquisition – will generate \$50M of proceeds/gain. Client funds \$30M to a 20-year term CRUT, 10% pay-out. Assume 4% growth and 5% income on reinvested proceeds.
- Example 3 – Client is an OR (Multnomah) Resident and funds a CRUT with stock pre-sale – sale occurs near year-end.
 - Client Receives \$10.75M charitable deduction – utilized fully with 5-year carryover
 - CRUT Capital Gain in Year 1 + ~\$20M of capital gain.
 - Year 2 – Clients moves to Oregon wine country
 - Client receives \$20M (gross) in year 1 + \$43M from CRUT. Leaves \$61.4M to charity.
 - ~\$43M avoids Metro + PFA Tax (4%) = \$1.7M

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