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Overlooked and Misunderstood: Common Tax and Estate Pitfalls

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With You Today

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Agenda

1. Estate Planning & Trust Administration
2. Gifts & Charitable Giving
3. Final Estate Administration
4. International Tax Compliance
5. IRS & State Controversy

Estate Planning & Trust Administration

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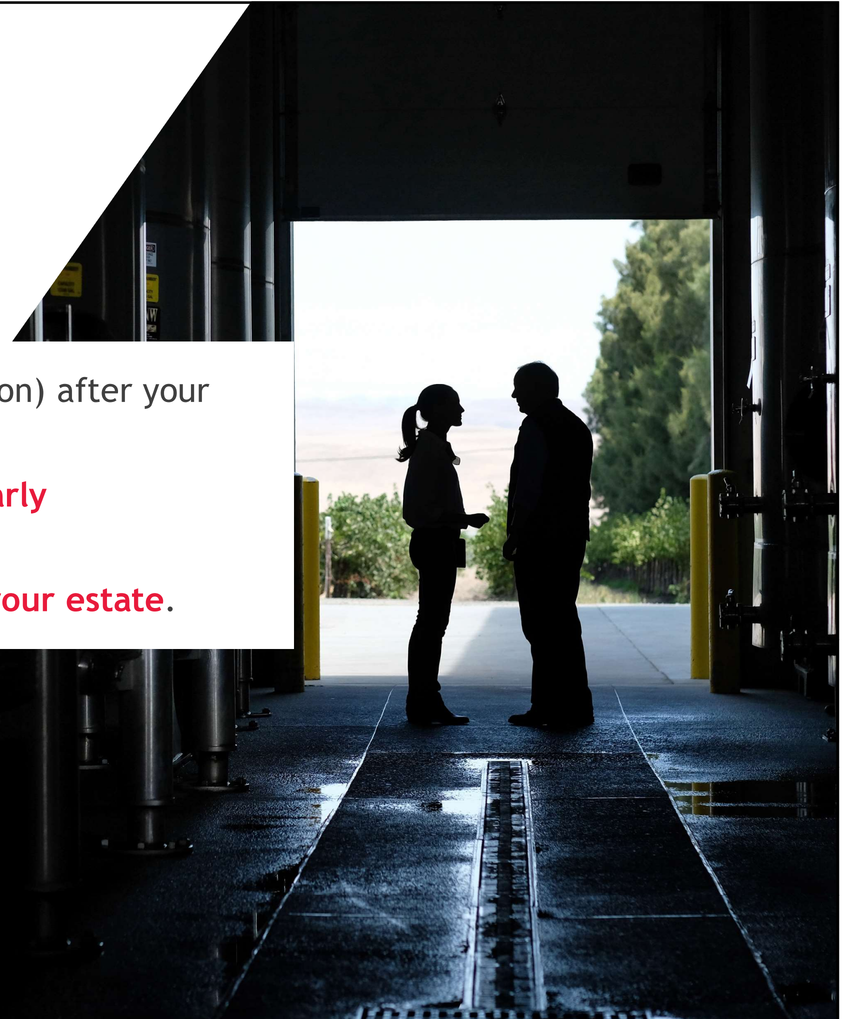
Procrastination

- Without an estate plan, assets with pass according to state law and may result in additional taxes paid. Don't let the government control your estate.
- Your estate plan may consist of a **will**, **trust**, **financial power of attorney**, **health care power of attorney**, and **advance care directives**.
- Once you have your estate planning documents in place, **don't forget to periodically review them**, especially when you have a major life event (i.e., birth of a child or divorce) or there are major tax law changes.

Discussing Inheritance

- Set expectations to **lessen disagreements** (and litigation) after your death;
- Help ensure your goals, wishes, and intentions are **clearly communicated**; and
- Prepare the beneficiaries and executor for **managing your estate**.



You built it, now what?

- You spent a **significant portion** of your life building and running your business.
- **What happens** to the business when you retire, die, or become disabled?
- What are your **long-term plans** for the business?
- A **business succession plan** can help your business survive an unforeseen event; promote communication about and plan for the future of the company; and help the company maintain its reputation, image and credibility.

Corralling the Trust Return

- **A trust may be taxed in multiple states that may change each year:**
  - Location of assets, income, grantor, custodians, advisors, trustees, protectors, or other fiduciaries
  - What state law applies or court relationship
  - Distributions to beneficiaries
  - Beneficiary residency and if they have some control over the trust property

- Resident trust status may change, but is hardest to remove based on grantor residency when the trust became irrevocable
  - Favorable rulings in Minnesota and Illinois
  - US Supreme Court has stated that discretionary beneficiary residence alone is insufficient
  - California has a throwback tax for trust income distributed after accumulation to a beneficiary

Who Paid What

- Certain expenses are incurred in administering an irrevocable trust, for example, **tax preparation fees**, **state and local real property taxes**, and **state and local income taxes**.
- These expenses are the responsibility of the trust and should be paid by the trust. When a settlor or beneficiary pays any of those expenses (on behalf of the trust), **a whole host of issues presents themselves**.
- Did the settlor/beneficiary make a gift to the trust, and if so, how did the gift affect the trust's generation skipping transfer tax exemption?
- Should a gift tax return have been filed? Is the beneficiary now a settlor of the trust too?
- Is inclusion in the gross estate for estate tax purposes a concern?
- If the trust lacks liquidity, then planning should be considered to raise the necessary cash.

Designate a Beneficiary, Already

- **Beneficiary designations** are an important estate planning tool, which allow assets to pass outside the will or revocable trust.
- Certain assets, **such as life insurance and retirement accounts**, pass by beneficiary designations.
- Not naming a beneficiary causes these assets to be distributed to the estate, often resulting in **unexpected tax consequences**.
- Primary and contingent beneficiaries **should be named**.
- Beneficiary designations, like estate planning documents, **should be reviewed periodically** for major life events and major tax law changes.

Gifts & Charitable Giving

2

Appraisal, Appraisal, Appraisal

- A gift must be **adequately disclosed** on a gift tax return to ensure that the 3-year statute of limitations runs on that gift, preventing the IRS from revaluing the gift and assessing additional tax.
- A description of the property gifted, trust information, and **qualified appraisals by qualified appraisers** for noncash gifts are generally required to meet the adequate disclosure requirements.
- If a gift is not adequately disclosed, the statute of limitations never starts during the grantor's lifetime – meaning the IRS can revalue the gift and assess additional tax **beyond the deathbed**.

Use It or lose It

For 2025, the estate, gift, and generation-skipping transfer (GST) tax exemption amount is **$13.99 million per person**; however, in 2026 that amount is set to revert back to an estimated **$7 million per person**.

(Increased exemption may be extended by the Trump administration)

Along with an increased exemption amount, there are **additional strategies** that may be leveraged that may not always be available. It is critical to develop giving plans and put them into motion **before it is too late**.

Report Those Gifts to Trust

- Generally, **gifts of cash equal to or less than the annual gift tax exclusion** amount do not have to be reported on a gift tax return.
  - 2024 $18,000
  - 2025 $19,000
- Everyone has their own exclusion, so a married couple may give their child $36,000 combined in 2024 without using lifetime exemption.
  - Filing may be needed if splitting the gift

- Transfers to a trust are eligible for the **annual gift tax exclusion amount** when trust beneficiaries are given the right to withdraw that amount at the time of the contribution.
- Most gifts to trust do **not qualify for GST annual exclusion**, that generally requires:
  - Only one beneficiary
  - Distributed during their life or to their estate

Generation-Skipping Transfer Tax

- **GST tax is an additional 40% tax** generally on non-GST exempt distributions to beneficiaries more than 1 generation below the grantor (ex. grandchildren)
- Each person is currently given the same amount of GST exemption as estate and gift - $13.99M. This is best allocated to a long duration trust for the benefit of multiple generations.
  - If ALL the transfers to the trust are allocated GST exemption, then ALL future distributions will be exempt from GST tax, regardless of the generation of the beneficiary.
  - Trust jurisdiction may be chosen for trust duration purposes.

Gift It or Step-It Up

- When you **gift an asset** during your lifetime, the recipient takes that asset at your **carryover basis**.
- When a taxpayer **dies owning an asset**, it generally receives a **basis step-up**, reducing the taxable gain on a future sale.
- There are multiple factors to consider in making such a decision, including:
  - Age and health of the grantor
  - Potential appreciation of the asset, its location, and type of income
  - Anticipated changes in tax law
  - Grantor goals

Charitable Substantiation, Seriously

- The IRS continues to surprise taxpayers by disallowing their charitable contribution deductions, in their entirety, for **failure to substantiate the contribution properly and fully**.
- Taxpayers have been left out in the cold, without a charitable deduction, for:
  - (i) failing to obtain a complete contemporaneous written acknowledgment,
  - (ii) for failing to obtain or attach a qualified appraisal to the tax return (when required), and
  - (iii) for failing to attach Form 8283 (Noncash Charitable Contributions) or attaching an incomplete Form 8283 (i.e., basis information was missing) to the tax return.

Final Estate Administration

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Estate Taxes & Executors

- If the decedent is **not married at the time of death** and the estate is below applicable filing thresholds (federal and state), then a Form 706 (Estate Tax Return) is **not needed**.
  - Over a dozen states have estate or inheritance tax at lower exemptions
- If there is a surviving spouse, **consider filing for portability**.
  - Portability allows a surviving spouse to use the remaining unused exemption amount from the deceased spouse's estate.

- Estate tax is due within 9 months of the date of death; the tax return may be extended by 6 months.
  - Complex return requiring asset valuations as of the date of death owned by the decedent
  - Executor is responsible for coordinating necessary documentation and signing all applicable tax returns
  - Executor should be careful not to distribute assets that may be needed to pay taxes or other expenses, or may be personally liable

International Tax Compliance

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Worldwide Reporting

- As long as you are a U.S. citizen, you are taxed on your worldwide income, no matter where you live, and no matter for how long. **U.S. taxes are based on citizenship, not country of residence**.
- As a U.S. citizen, you are required to file a U.S. federal income tax return and **pay U.S. taxes on your worldwide income**.
- By the way, **resident aliens** also are required to report their worldwide income.

Disclose, Disclose, Disclose

- Enquiring minds want to know, and the IRS definitely wants to know what foreign assets a U.S. citizen and resident alien owns, **even if those assets do not generate income**.
- **Foreign assets** include foreign bank accounts, foreign securities, foreign partnership interests, foreign investment assets held by a trust, and foreign-issued life insurance or annuity contracts.
- Also, the IRS wants to know about the **creation of**, **transfer to**, and **transactions with** a foreign trust.
- And the IRS wants to be kept up to date on gifts from a **foreign estate**, **nonresident alien**, **foreign corporation**, or **foreign partnership**.

Disclose, Disclose, Disclose

- The IRS has provided a handful of forms to disclose these various foreign assets and gifts:
  - Form 114
  - Form 8938
  - Form 3520
  - Form 3520-A
  - Form 5471
  - Form 5472
  - Form 8865

Penalties can be substantial for taxpayers who fail to timely file the form.

Congratulations, It's a Foreign Trust

- U.S. citizens who work abroad often participate in foreign pension plans.
- These plans are commonly encountered in countries such as Canada, France, Australia, Hong Kong, Singapore, and the United Kingdom.
- Foreign pension plans are a foreign asset that must be disclosed by the taxpayer.
- Certain pension plans (e.g., self-funded plans) are considered foreign grantor trusts, in which there is no deduction for contributions and no tax deferral on accrual of income, unless treaty benefits apply.
- Australia superannuation plans and United Kingdom self-invested personal pensions (SIPPs) are generally treated as foreign grantor trusts for U.S. tax purposes.
- This treatment raises the level of reporting required and complexity encountered.

IRS & State Controversy

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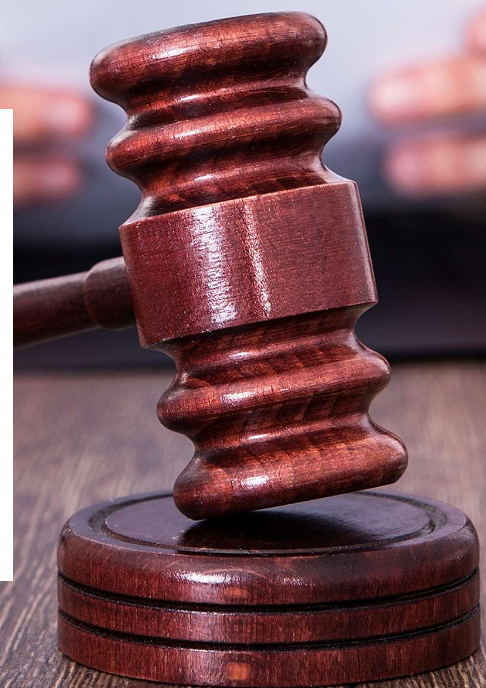
Ignoring Notices

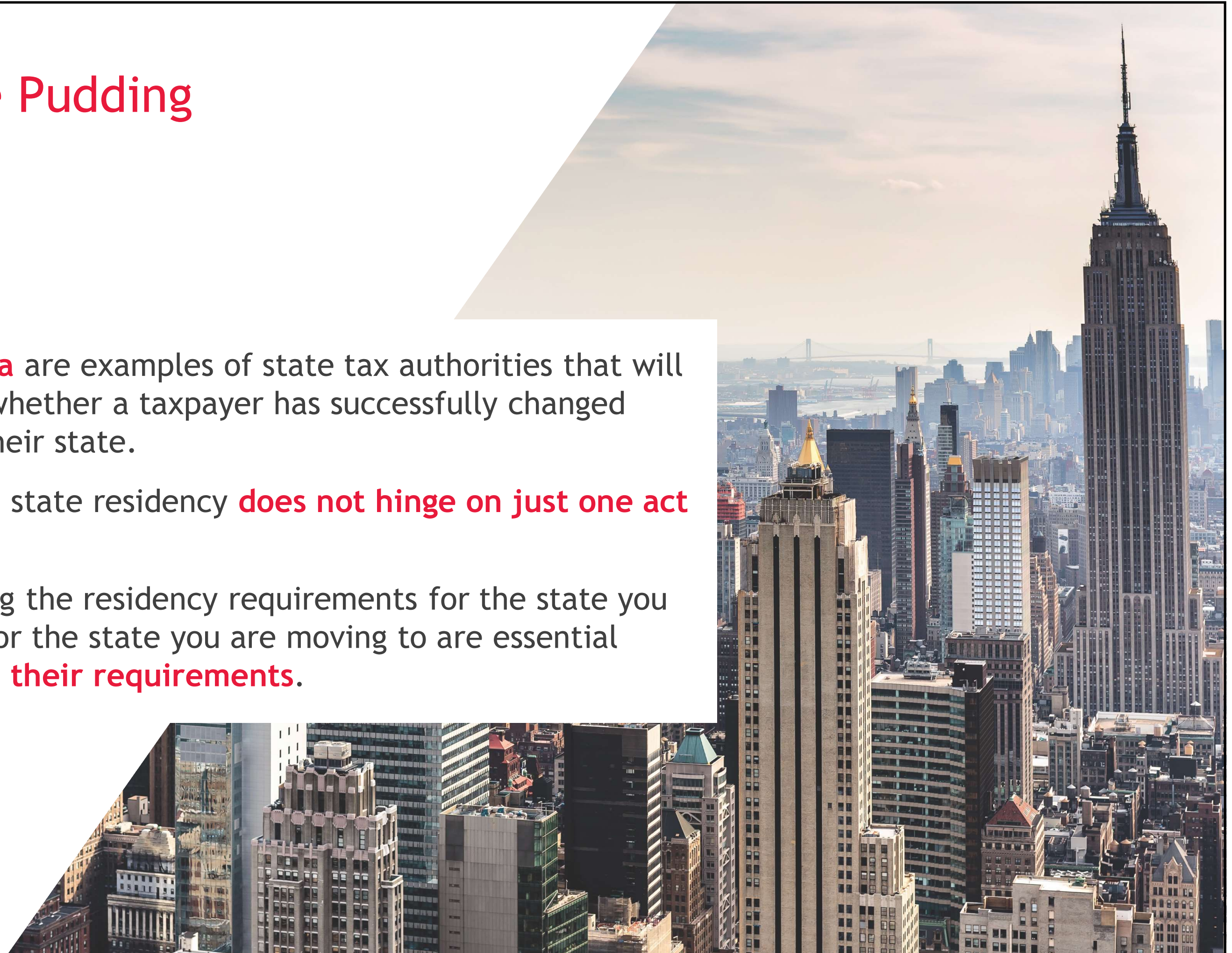
- **Never a good idea**. The clock is ticking with strict deadlines and procedures for responding to notices ... your rights are vanishing, and penalties and interest are accruing.
- Collections may be forthcoming. **Notices do not expire**; nor do they go away.
- Keep your address up to date with the IRS; **notices are not automatically forwarded** to your current living address.
- Even a slight delay in responding to a notice may preclude a simple resolution. Read the notice when received AND seek out your **tax professional for assistance**.
- Consider granting a **power of attorney to your CPA or legal counsel**, so that they also will receive copies of the notice. This provides some assurance that someone will receive a copy of the notice and timely respond to the IRS.

Representing Yourself

- **Not a good idea**. Taxpayers, generally, are not aware of their rights during an audit and are **unfamiliar with the audit methods and procedures** of the IRS.
- An unrepresented taxpayer may **inadvertently expand the scope of an audit** and **negatively affect the audit outcome** by simply providing too much information.
- A tax professional may restrict the scope of the audit, handle all contact with the auditor, **help avoid** or **minimize penalties**, and **appeal the outcome**, if needed.



The Proof is in the Pudding



- **New York** and **California** are examples of state tax authorities that will aggressively challenge whether a taxpayer has successfully changed their residency out of their state.
- Establishing and proving state residency **does not hinge on just one act but on several acts**.
- Of course, understanding the residency requirements for the state you are moving out of and for the state you are moving to are essential because **states differ in their requirements**.

The Proof is in the Pudding

Common steps taxpayers may take to establish residency in a new state include

- Purchasing a home
- Registering to vote
- Engaging local medical professionals
- Obtaining a new driver's license
- Changing your mailing address
- Filing a resident state income tax return (if applicable)
- Changing bank accounts to the new state
- Bringing your family and pets with you to the new state
- Filing a nonresident state income tax return in your former state (if applicable)
- Focusing your activities in your new state

The Proof is in the Pudding

- Believe it or not, it is possible **to be a resident of more than one state at the same time**!
- The need to **document** and **retain documentation** cannot be overemphasized.
- For those taxpayers **that winter in one state and summer in another state**, the number of days spent in each state can be important.
- **Keep a daily calendar** showing where you were each day, including receipts for those days.

Questions?

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Upcoming Events

Event	Date
Family Office Design Workshop | Virtual	Nov. 18 – 21
Member Webcast: Takeaways from the FOX Global Investment Survey	Nov. 20
Member Webcast: Insights from FOX's 2024 Compensation and Benefits Study	Dec. 4
2025 ROEF Academy | Amsterdam, Miami, & Virtual Modules	Starts Jan. 27
2025 Private Trust Company Workshop | Virtual	Jan. 28 – 30
2025 Build an Enterprise Family to Last Workshop | Miami, FL	Feb. 5 - 7
2025 Rising Gen Leadership Program: Topaz Edition | Nashville, TN	Mar. 21 – 22

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