# THE ESTATE PLANNER

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**LOAN OR GIFT?**
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Estate Planning Red Flag
You've elected to split gifts with your spouse

The Michael Law Group, PC

Jonathan W. Michael
Partner

JMichael@themichaellawgroup.com

Main (312) 900 0150
Direct (312) 900 0151
Fax (312) 900 0149

311 South Wacker Drive
Suite 1590
Chicago, Illinois 60606
www.themichaellawgroup.com

# Loan or gift?

*Handle intrafamily transfers with care*

If you're like most people, an important goal of estate planning is to provide financial assistance to your children or other loved ones, ideally at the lowest possible tax cost. There are many strategies for achieving this goal, including outright gifts (either during life or through bequests in your will) and gifts in trust.

Another option is to make loans to family members. Intrafamily loans offer several benefits, but to enjoy those benefits it's critical to treat these transactions as legitimate loans. Otherwise, the IRS may determine that they're disguised gifts, which can trigger negative tax consequences (assuming you're subject to gift and estate taxes).

## Benefits of intrafamily loans

One positive aspect of lending money to your loved ones rather than making outright gifts is that it allows you to help them financially without parting with the funds permanently. This can be advantageous if you believe that you'll need the funds in retirement. Making loans can also be a great way to teach family members about financial responsibility.

From a tax perspective, intrafamily loans allow you to transfer wealth tax-free. Here's how it works: When you make a loan to a family member, charge interest at the applicable federal rate (AFR). (Charging no interest or interest below the AFR can lead to unwelcome tax surprises.) To the extent that the borrower

earns returns on the funds in excess of the interest payments on the loan (by investing them in a business opportunity, for example), the borrower pockets those earnings free of gift and estate tax.

Note that intrafamily loans don't enable you to avoid gift and estate tax on the loan principal itself. The outstanding balance is included in the lender's taxable estate, even if the lender dies before the loan is paid off. In that case, either the borrower will be obligated to repay the loan to the estate or, if the loan terms call for it to be forgiven upon the death of the lender, that forgiveness will be treated as a taxable transfer.

## Loan vs. gift

The IRS presumes that intrafamily transactions are gifts. So, to ensure that a loan is treated as such, you must take steps to demonstrate that you and the borrower have a bona fide creditor-debtor relationship. To decide whether an advance is a loan or a gift, the IRS and the courts consider the "Miller" factors, under which an advance is more likely to be treated as a loan if:

- There was a promissory note or other evidence of indebtedness,
- Interest was charged,
- There was security or collateral,
- There was a fixed maturity date,
- A demand for repayment was made,
- Actual repayment was made,
- The transferee had the ability to repay,
- The parties maintained records treating the transaction as a loan, and
- The parties treated the transaction as a loan for federal tax purposes.

These factors aren't exclusive. Also, the courts generally view an actual expectation of repayment and an intent to enforce the debt as critical to a finding that an advance is a loan.

## Is now the time to forgive intrafamily loans?

Keep in mind that the gift and estate tax exemption amount for 2024 is $13.61 million for individuals (a combined $27.22 million for married couples) and those amounts will be cut roughly in half in 2026, unless Congress intervenes. As long as your wealth is well within the exemption amount, treatment of an advance as a gift rather than a loan won't trigger gift or estate tax.

If you have outstanding intrafamily loans and you're concerned that the IRS may treat them as gifts, consider forgiving them before the end of 2025 to ensure that your gift locks in the higher exemption amount. Unless you really need the interest income, forgiving loans will allow you to transfer the funds tax free without the risk that future exemption amounts won't be sufficient to shield them from tax.

## Loan today, gift tomorrow

As illustrated by a recent federal court case, a history of intrafamily loans is no guarantee that subsequent advances won't be treated as gifts. *Estate of Bolles* involved a mother who, from 1985 through 2007, made a series of payments to her son totaling more than $1 million. The mother characterized the payments as loans to assist her son in running the family business, though there was no promissory note or other evidence of indebtedness.

The son repaid some of the advances but made no payments after 1988, when the business ran into financial difficulty (and ultimately failed). In her revocable trust dated October 27, 1989, the mother

specifically excluded the son from any distribution of her estate. In 1995, she amended the trust to reduce any distribution by the amount of the unpaid "loans," rather than exclude him altogether. Around the same time, the son signed an acknowledgement that "he has neither the assets, nor the earning capacity, to repay" the previous loans.

The U.S. Tax Court, in a decision affirmed by the 9th U.S. Circuit Court of Appeals, found that the payments from 1985 through 1989 were loans, because the mother expected the son to make a success of the business. But by the time she executed her trust, she realized that the advances were unlikely to be repaid. The payments lost their characterization as loans at that time, the court explained, and became advances on the son's inheritance.

### Dot the i's and cross the t's

If you make loans to family members, it's important to observe the formalities associated with bona fide loans to ensure the desired tax treatment. Among other things, this means having the borrower sign a promissory note, charging sufficient interest and making an effort to collect. ▮

# Address these estate planning priorities first

It's been said that there's "no time like the present." That's especially true when it comes to your estate plan. Even though creating an estate plan may seem overwhelming, there are several "top priority" items you should tackle first. Failing to do so can leave your family at a loss if you die unexpectedly.

### Appoint an executor

Don't leave the burden of managing your estate to one or more family members without providing adequate direction. In fact, you can assemble an expert "team" that can help your family navigate the tricky waters.

The executor is the captain of the team. He or she should be knowledgeable, competent and willing to perform the duties. An executor may be a family member, such as your spouse, adult child or a sibling. Other choices include a close friend or an experienced professional advisor. The executor you name will have to coordinate activities with attorneys, bankers and appraisers.

> ***Don't leave the burden of managing your estate to one or more family members without providing adequate direction.***

After you've named an executor, move on to other priorities. A financial power of attorney authorizes an "attorney-in-fact" to act on your behalf for financial matters. The most common power of attorney, a "durable" one, remains viable if you're incapacitated. With another variation, a "springing" power of attorney, control doesn't take effect until incapacitation.

Frequently, the person designated as the attorney-in-fact is the same person as your executor. His or

her power may be broad, encompassing such matters as buying or selling personal property, or limited to certain tasks.

## Create health care directives

Complex decisions typically arise near the end of a person's life. You can simplify matters by assembling a comprehensive list of health care directives. They may include a:

**Health care power of attorney.** Comparable to a financial power of attorney, this document authorizes another person to make health care decisions on your behalf if you're unable. Typically, the attorney-in-fact is a spouse, child or sibling. It may be broad or limited and expires on death.

**Living will.** As opposed to a health care power of attorney, a living will is reserved for end-of-life situations. Depending on state law, it may allow you to express whether life-sustaining treatment should be administered in the event you're terminally ill or injured.

A health care power of attorney and a living will may be combined into one document, depending on state law. In other states, a living will may supplement a health care power of attorney. Both documents may be coordinated with other medical directives or proxies.

**Medical orders for life-sustaining treatment.** This includes medical orders signed by a physician to assist patients who've been diagnosed with a life-threatening or terminal illness or disease. These orders may also be created if you're not currently ill and will take effect only in end-of-life situations.

## Form a gifting strategy

Most likely one of your top priorities is to ensure that your assets are passed to loved ones without adverse gift or estate tax consequences. Although sophisticated techniques can be used, two basic tax law provisions often provide a foundation:

**Gift and estate tax exemption.** For 2024, you can shelter up to $13.61 million from gift and estate tax, in addition to amounts covered by the annual gift tax exclusion (see below). Any unused portion of your exemption is available to the estate of your surviving spouse with a portability election on a timely filed estate tax return.

**Gift tax exclusion.** Under the annual gift tax exclusion, you can give each recipient up to $18,000 in 2024 without any gift tax liability, thereby removing assets from your taxable estate.

These two provisions may be coordinated with other strategies, such as using a trust, that maximize the tax benefits while offering other advantages.

## Take the next steps

There are many hurdles to overcome in estate planning. They can include potential estate taxes, complex tax laws and a lengthy probate process. But the biggest obstacle is often self-imposed: procrastination. Now's the time to take the first steps to form your estate plan. Your estate planning advisor and attorney can be vital resources in helping you achieve your goals. ▮

# Beware of inheritance scams

Whenever large sums of money are involved, don't be surprised if scammers come out of the woodwork. This is especially true today, as criminals have a variety of tools at their disposal, such as phishing emails, designed to separate you from your hard-earned wealth. Here are examples of inheritance-related frauds as well as a few other financial-related frauds.

## Inheritance scams

Not surprising, inheritance scams typically promise a significant financial windfall. In one scam, you might receive a letter from a "law firm" (or perhaps a "bank") claiming that one of its clients has died, leaving a large inheritance or life insurance policy. The entity was unsuccessful in attempting to reach the client's family members and believe that you're a distant relative. Often, the "firm" will offer to split the inheritance or life insurance proceeds with you, the firm and some charities.

However, here's the catch: To obtain your new-found wealth, you need to send a payment to cover the taxes and fees. Or you may need to provide your Social Security number, birthdate and bank account number so they can wire you the funds. If you receive this type of communication, don't respond. It's nearly always a scam designed to steal your money or your identity (or both).

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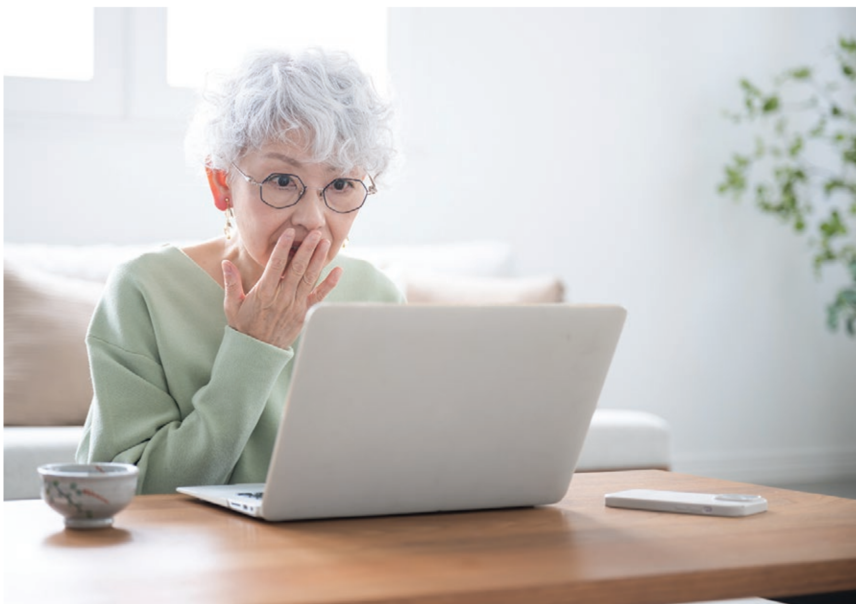
Another scam involves an email or text purportedly from the IRS, claiming that you owe tax on a large inheritance. Even if you did receive an inheritance, you shouldn't reply to these messages or click on any attachments.

For one thing, the IRS never initiates contact with taxpayers regarding tax bills or refunds via text, email or social media — it almost always uses regular mail. Plus, there's no federal inheritance tax. The federal estate tax is paid by the estate, not those to whom the estate is distributed. (Note that a few states have inheritance taxes.)



## Fake charities

Fraudsters may pose as charitable organizations to steal your money as well as your identity. And, adding insult to injury, you can also lose valuable tax deductions.

Often, fake charities claim to be raising funds to help victims of natural disasters or wars, and they may use names that sound similar to well-known charities. They may also use fake emails or manipulated caller IDs to convince you they're legitimate.

The IRS urges people to resist pressure tactics (legitimate charities rarely resort to such tactics), avoid organizations that request donations by gift card or wire transfers, and never share your Social Security number or other unnecessary personal or financial information.

To avoid these scams, always vet an organization before you donate — for example, by using the Tax-Exempt Organization Search tool on the IRS's website — and only make donations by check or credit card.

## Don't fall victim

To avoid falling victim to these and other scams, always be vigilant, especially when contacted by email, text or social media. And when in doubt, talk to your advisor to help determine a communication's validity.

ESTATE PLANNING RED FLAG

## You've elected to split gifts with your spouse

Splitting gifts with your spouse can help minimize taxes on gifts of separate property — as opposed to jointly owned or marital property. However, in certain cases, it can have undesirable consequences. Indeed, it's important to understand the implications before making an election to split gifts.

Suppose, for example, that in 2024 you give your child $36,000 in stock that's your separate property. The annual gift tax exclusion shields half of that amount from gift taxes, but the remaining $18,000 is taxable. However, if you and your spouse elect to split gifts, then half of the gift is deemed to be from your spouse and is shielded from tax by his or her annual exclusion.

It's important to understand that when you make an election to split gifts on a gift tax return, it applies to *all* gifts made by you or your spouse during the year. In some cases, this can have unintended consequences, especially if you plan to leverage the $13.61 million (for 2024) federal gift and estate tax exemption.

Because the exemption is scheduled to be cut in half after 2025, many people are taking advantage of the current amount by making large gifts to their loved ones before the current exemption sunsets in 2026. But if you elect to split gifts, you risk losing the benefit of the increased exemption.

Suppose that in 2024 you transfer interests in your separately owned business valued at $13.61 million to your children. If you and your spouse elect to split gifts this year, then each of you is deemed to have made a gift of $6.805 million. If the exemption amount drops to $6.805 million in 2026 (ignoring inflation adjustments), you and your spouse will both have used up your exemptions. Had you elected not to split gifts in 2024, however, you would have enjoyed your full increased exemption amount, while preserving your spouse's $6.805 million exemption.

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# Tax and estate planning strategies for charitable giving

*While the concept is straightforward—you give to charity, the IRS gives you a tax break—how and when to get the job done is anything but. Here are few things to keep in mind.*

When the holiday season rolls around, helping others is often top-of-mind, as is how to help most effectively. Can you supplement your decision making with the right tax-planning strategies? Which are best for you? We can help, and here's how.

**The good news is you can start** the process right now so your estate planning isn't caught up in any sort of holiday "rush." There are a few basic approaches but the specifics vary and, as always in the world of estate and trust planning and administration, there are nuances that increase the complexity of making good decisions.

Broadly speaking, proper planning can reduce three types of taxes: income, capital gains, and estate. Here are a few of the tools to make sure you maximize the overall benefit of your gifts:

**1. Carryovers:** You were feeling exceedingly generous or a recipient had a significant need, so your gifts exceeded the maximum amount deductible in that year. Using a charitable contribution "carryover" might be the answer. As the name implies, deductions are spread out and applied over time—five years is the current limit—and respective total deductions for cash versus non-cash assets are still in place.

**2. Bonds, Stocks, and Real Estate:** The donation of long-term appreciated assets can come with an attractive two-prong advantage. First, in general, the gain that would be taxed if the asset were sold is not recognized, meaning the capital gains tax is avoided. Second, the income tax charitable deductions can be taken at full fair market value, although limits based on a percentage of adjusted gross income apply.

**3. Combined Multiple-Year Deductions:** Taxpayers whose itemized deductions don't exceed the standard deduction threshold might benefit from this tactic. Also known as "bunching," it is a strategy whereby the taxpayer will consolidate their donations for two years into a single year to maximize the taxpayer's itemized deduction for the year in which it is made. In short, instead of making contributions in two consecutive years that will not maximize the taxpayer's itemized deduction in either year, combine the donation into a single year that will maximize the taxpayer's itemized deduction.

Another "bunching" technique is to establish a Donor Advised Fund, in which case the deduction is available in the year of contribution to the Donor Advised Fund, but the actual distributions to charity could be at any time in the future.

**4. Legacy Charitable Support:** Depending on the structure of your estate plan, chosen charities can continue to receive your support even after your death. Both charities and heirs can benefit because you can reduce estate taxes.

**5. Cash versus Non-Cash Assets:** If charitable donations are made only with cash or only with non-cash assets (stocks, bonds, real estate, etc.), the limits are straightforward. Deductions of cash donations are limited to 60 percent of adjusted gross income while deductions of non-cash donations are limited to 30 percent. The calculation of the maximum amount deductible in a tax year is trickier when a combination of cash and non-cash assets is donated, and the structure of the gifts can affect the result.

**Please take a few minutes now** to give us a call and help us help you make productive decisions for your charitable giving. The impact on everyone isn't only for this tax year but also for years into the future.

The Michael Law Group, PC


The Michael Law Group, PC / 312-900-0150 / JMichael@themichaellawgroup.com

www.themichaellawgroup.com