THE ESTATE PLANNER

March/April 2019

DONATING TO CHARITY?
Watch out for new appraisal regs

Stay true to your family with a total return unitrust

The HSA: A healthy supplement to your savings regimen

Estate Planning Red Flag

You have assets in payable-on-death accounts

MacLean & Ema P.A.
Attorneys and Counselors at Law

2600 NE 14th St Causeway
Pompano Beach, FL 33062

954-785-1900 phone
954-942-1006 fax

www.maclean-ema.com

Donating to charity?

Watch out for new appraisal regs

If you make substantial noncash gifts to charity, it's important to familiarize yourself with new requirements for qualified appraisals. A qualified appraisal must accompany noncash gifts over $5,000 (with certain exceptions), including groups of similar items whose total value exceeds $5,000 (even if donated to separate recipients).

Recently, the IRS finalized 10-year-old proposed regulations regarding substantiation and reporting requirements for charitable deductions. For the most part, the final regs are similar to the proposed regs, but there are some significant changes to the rules on qualifications of appraisers and the contents of their appraisals, effective January 1, 2019.

Strict compliance with these rules is critical. Otherwise, you may lose valuable tax deductions, even if a donation is otherwise legitimate and the reported value is accurate.

Substantiation requirements

To substantiate noncash charitable contributions over $5,000 ($10,000 for closely held stock), you must, subject to certain exceptions noted below:

- Obtain a contemporaneous written acknowledgment (CWA) from the recipient stating 1) the amount of your contribution, and 2) a description and good-faith estimate of the value of any goods or services provided in consideration of your contribution,
- Obtain a qualified appraisal of the property by a qualified appraiser,
- File Form 8283 (Section B) — signed by you, the recipient and the appraiser — with your federal income tax return on which the deduction is claimed, and
- For contributions over $500,000, attach a copy of the appraisal to your return.

You must obtain the CWA and appraisal by the extended due date of your tax return or, if earlier, the date you file your return. No appraisal is required for certain types of property, including publicly traded stock, vehicles (if your deduction is limited to the gross sale proceeds), certain inventory and intellectual property.

What's a qualified appraisal?

To qualify, an appraisal must be prepared by a qualified appraiser in accordance with generally accepted appraisal standards. Some commentators urged the IRS to require strict compliance with the Uniform Standards of Professional Appraisal Practice (USPAP),

developed by the Appraisal Standards Board of the Appraisal Foundation. Fortunately, the final regs define generally accepted appraisal standards to mean the "substance and principles" of USPAP, giving appraisers the flexibility to follow appraisal standards developed by other organizations.

The final regs also include a detailed list of information an appraisal must contain. The appraisal must be signed and dated by the appraiser no earlier than 60 days before the property is contributed and no later than the extended due date of your return.

Who's a qualified appraiser?

A qualified appraiser is someone with "verifiable education and experience in valuing the type of property for which the appraisal is performed." (See "People who *aren't* qualified appraisers" at right.) The education and experience requirement may be satisfied by either:

- Successfully completing certain professional or college-level coursework *and* obtaining two or more years of experience in valuing the type of property being appraised, or
- Earning a recognized appraiser designation from a generally recognized professional appraiser organization.

Coursework must be obtained from an educational institution, a generally recognized professional trade or appraiser organization, or a satisfactory employer educational program.

A qualified appraiser need not have education and experience in valuing property identical to the property being appraised. According to the final regs, "type of property" means "the category of property customary in the appraisal field for an appraiser to value." So, for example, if it's customary for professional antique appraisers to appraise antique widgets, an appraiser with two years of experience in valuing antiques generally would be qualified to appraise an antique widget.

People who *aren't* qualified appraisers

The final regulations specify that the following individuals are *not* qualified appraisers, regardless of their education and experience:

1. You, as the donor of the property,
2. The recipient of the property,
3. A party to the transaction in which you acquired the property (the person who sold or gave it to you, for example), unless you contribute the property within two months after you acquire it and its appraised value doesn't exceed its purchase price,
4. Certain relatives and employees of the individuals listed above (and the spouses of such relatives and employees),
5. An independent contractor who regularly performs appraisals for any of the individuals listed in (1), (2) and (3) above and doesn't perform a majority of his or her appraisals for others,
6. One who has been suspended from practice before the IRS at any time during the previous three years, or
7. One who receives a prohibited appraisal fee — that is, a fee based to any extent on the property's appraised value, including one that depends on the value allowed by the IRS after an examination.

Suppose, however, that it's not customary for professional antique appraisers to value new widgets. An appraiser with experience in valuing antiques generally but no experience in appraising new widgets wouldn't be considered qualified to conduct a valuation of this type of property.

Vet your appraisers

If you donate property to a charity that requires a qualified appraisal, do your homework to be sure your appraiser has the necessary credentials and experience. An appraisal by a nonqualified appraiser, no matter how thorough and accurate, will jeopardize the deductibility of your gift. ▮

Stay true to your family with a total return unitrust

Even in the strongest families, conflicting interests between income and remainder beneficiaries can create tension and turn the trustee's job into a delicate balancing act. By aligning your beneficiaries' interests, a total return unitrust (TRU) can relieve this tension and allow your trustee to concentrate on developing the most effective investment strategy.

A difficult job

When a trust is designed to provide benefits for two classes of beneficiaries, often in different generations, it presents a difficult challenge for the trustee.

> *When a trust is designed to provide benefits for two classes of beneficiaries, often in different generations, it presents a difficult challenge for the trustee.*

For example, let's say Susan's will establishes a trust that pays all its income to her husband, Mark, for life (the "lifetime beneficiary"), and then divides the trust assets equally among her three children from her first marriage (the "remainder beneficiaries"). The trust names Susan's friend, Jennifer, as trustee. Mark outlives Susan by 10 years.

Jennifer has a fiduciary duty to act in the best interests of all the beneficiaries, but traditional trust design makes it difficult for her to be impartial. Suppose Susan leaves $2 million to the trust. To provide Mark with a steady income stream, Jennifer places the trust assets in fixed-income investments that generate a 5% return. Mark receives income of $100,000 per year, and when he dies the trust's principal — still $2 million — is distributed to Susan's children. Not a bad inheritance, but its value has been eroded by 10 years of inflation.

Suppose, instead, that Jennifer invests the trust assets in growth stocks that earn a 9% annual return. Ten years later, the trust's value has appreciated to more than $4.7 million. That's good news for Susan's children, but this approach likely generates little or no income for Mark.

To make everyone happy, Jennifer makes a compromise: She invests half of the assets in growth stocks and the other half in fixed-income vehicles. The $1 million in fixed-income investments generates $50,000 per year for Mark, and at the end of the trust term the principal is still $1 million. The other $1 million, however, has grown to nearly $2.4 million. Thus, the total amount in the trust is almost $3.4 million.

A TRU introduces flexibility

The advantage of a TRU is that it frees the trustee to employ investment strategies that maximize growth (total return) for the remainder beneficiaries without depriving lifetime beneficiaries of income. Rather than pay out its income to the lifetime beneficiary, a TRU pays out a fixed percentage (typically between 3% and 5%) of the trust's value, recalculated annually, regardless of the trust's earnings.

Going back to our previous example, suppose Susan's trust is designed as a TRU that makes an annual payout to Mark equal to 3.5% of the trust's value, recalculated annually. Jennifer, relieved of the duty to generate income for Mark, invests the trust assets in a diversified portfolio of growth stocks that yield a 9% annual return. Mark's payments from the trust start at $70,000 and grow steadily over the trust's term, reaching more than $113,000 by year 10.

At the same time, the value of the trust principal grows to more than $3.4 million, which is distributed to Susan's children at the end of year 10.

Thus, the lifetime beneficiary and the remainder beneficiaries are better off with a TRU than they would have been under the compromise approach described earlier.

The details count

If you're considering implementing a TRU, it's important to plan carefully. Ask a financial advisor to project the benefits your beneficiaries will enjoy under various scenarios, including different payout rates, investment strategies and market conditions. Keep in mind that, for a TRU to be effective, it must produce returns that outperform the payout rate, so don't set the rate too high.

Be sure to investigate your state's trust laws. Some states disallow TRUs. Also, many states establish payout rates (or ranges of permissible rates) for TRUs, so your flexibility in designing a TRU may be limited. Finally, if a trust is required to pay out all its income to a current beneficiary, be sure that unitrust payouts will satisfy the definition of "income" under applicable state and federal law.

Thinking ahead

A trustee's job can be difficult when trying to balance the interests of various beneficiaries. Having the foresight to include a TRU in your estate plan can help relieve family tension later and make your trustee's job easier. Contact your estate planning advisor to learn more. ▮

The HSA: A healthy supplement to your savings regimen

Longer life expectancies and rising health care costs make saving for retirement more important than ever before. A Health Savings Account (HSA) can be a powerful tool for financing health care expenses while supplementing your other retirement savings vehicles. And it offers estate planning benefits to boot.

An HSA in action

Similar to a traditional IRA or 401(k) plan, an HSA is a tax-advantaged savings account funded with pretax dollars. Funds can be withdrawn tax-free to pay for a wide range of qualified medical expenses. (Withdrawals for nonqualified expenses are taxable and, if you're under 65, subject to penalties.)

To provide these benefits, an HSA must be coupled with a high-deductible health plan (HDHP). For 2019, an HDHP is a plan with a minimum deductible of $1,350 ($2,700 for family coverage) and maximum out-of-pocket expenses of $6,750 ($13,500 for family coverage). In addition, you must not be enrolled in Medicare or covered by any non-HDHP insurance (a spouse's plan, for example). Once you enroll in Medicare, you can no longer contribute to an HSA, but you can continue to withdraw funds to pay for qualified expenses.

Currently, the annual contribution limit for HSAs is $3,500 for individuals with self-only coverage and $7,000 for individuals with family coverage. If you're 55 or older, you can add another $1,000. Typically, contributions are made by individuals, but some employers contribute to employees' accounts.

HSA benefits

HSAs can lower health care costs in two ways: by reducing your insurance expense (HDHP premiums are substantially lower than those of other plans) and allowing you to pay qualified expenses with pretax dollars.

In addition, any funds remaining in an HSA may be carried over from year to year, continuing to grow on a tax-deferred basis indefinitely. This is a huge advantage over health care Flexible Spending Accounts, where the funds must be spent or forfeited (although some employers permit employees to carry over up to $500 per year). When you turn 65, you can withdraw funds penalty-free for *any* purpose (although funds that aren't used for qualified medical expenses are taxable).

To the extent that HSA funds aren't used to pay for qualified medical expenses, they behave much like an IRA or a 401(k) plan.

Estate planning and your HSA

Unlike traditional IRA and 401(k) plan accounts, HSAs need not make required minimum distributions once you reach age 70½. Except for funds used to pay qualified medical expenses, the account balance continues to grow on a tax-deferred basis indefinitely, providing additional assets for your heirs. The tax implications of inheriting an HSA differ substantially depending on who receives it, so it's important to consider your beneficiary designation.

Similar to a traditional IRA or 401(k) plan, an HSA is a tax-advantaged savings account funded with pretax dollars.

If you name your spouse as beneficiary, the inherited HSA will be treated as his or her own HSA. That means your spouse can allow the account to continue growing and withdraw funds tax-free for his or her own qualified medical expenses.

If you name your child or someone else other than your spouse as beneficiary, the HSA terminates and your beneficiary is taxed on the account's fair market value. It's possible to designate your estate as beneficiary, but in most cases that's not the best choice, because a beneficiary other than your estate can avoid taxes on qualified medical expenses paid with HSA funds within one year after death. When the estate is the beneficiary, the entire value of the HSA is taxable to you on your final income tax return. This presents a planning opportunity, particularly if you're in a lower tax bracket than the beneficiary or beneficiaries of the HSA.

A flexible tool

An HSA is a flexible tool that can be used to reduce health care costs, supplement your retirement savings, provide additional wealth for your heirs or all three. It's particularly attractive for those who are prevented by income limits from contributing to a deductible IRA. Like IRAs, HSA products have different investment choices and fees, so be sure to review your options and select an account that meets your needs. ▮

ESTATE PLANNING RED FLAG

You have assets in payable-on-death accounts

Payable-on-death (POD) accounts provide a quick, simple and inexpensive way to transfer assets outside of probate. They can be used for bank accounts, certificates of deposit or even brokerage accounts. Setting one up is as easy as providing the bank with a signed POD beneficiary designation form. When you die, your beneficiaries just need to present a certified copy of the death certificate and their identification to the bank, and the money or securities are theirs.

However, POD accounts can backfire if they're not coordinated carefully with the rest of your estate plan. Too often, people designate an account as POD as an afterthought, without considering whether it may conflict with their wills, trusts or other estate planning documents. Suppose, for example, that Martha dies with a will that divides her property equally among her three children. She also has a $50,000 bank account that's payable on death to her oldest child. The conflict between the will and POD designation must be resolved in court, which delays distribution of her estate and generates substantial attorneys' fees.

Another potential problem with POD accounts is that, if you use them for most of your assets, the assets left in your estate may be insufficient to pay debts, taxes or other expenses. Your executor would then have to initiate a proceeding to bring assets back into the estate.

Generally, POD accounts are best used to hold a modest amount of funds that are available immediately to your executor or other representative to pay funeral expenses or other pressing cash needs while your estate is being administered. Using these accounts for more substantial assets can lead to intrafamily disputes or costly litigation. If you use POD accounts as part of your estate plan, be sure to review the rest of your plan carefully to avoid potential conflicts.

MacLean & Ema P.A.

Attorneys and Counselors at Law

OWNERSHIP OF LLCs UNDER THE FLORIDA UNIFORM TRANSFER TO MINORS ACT

The Florida Uniform Transfers to Minors Act ("FUTMA") provides a relatively straightforward way to give a minor an ownership interest in assets while maintaining control until the minor reaches the age of majority. Most people who establish FUTMA accounts for children do so with cash or marketable securities.

FUTMA, however, does not limit the type of asset that a custodian can hold for a minor. In fact, FUTMA defines "custodial property" as "any interest in property transferred to a custodian under this act and the income from and proceeds of that interest in property." In other words, FUTMA authorizes a custodian to hold virtually any type of property for a minor. This could include interests in real estate; personal property; business entities, such as limited liability companies and corporations; intangible property such as proprietary rights, licenses, and intellectual property rights. The key to owning such an interest in property as a custodian for a minor is to clearly note that the custodian is holding the asset for the minor. FUTMA provides that a custodial ownership interest for the minor be clearly stated.

As above stated, if you wanted to give an interest in real property to a minor, you could. The deed would note that the interest in real estate was being held for the minor as by a custodian under FUTMA. Moreover, most of us do not own investment or commercial real estate individually, but instead, do so through an entity (such as a limited liability company) in order to limit liability and to meet certain asset protection objectives. If an interest in the real estate is being gifted, it may also be beneficial to make the gift through an LLC because certain valuation discounts for tax purposes may be available. The gift of real estate could be made by giving an interest in the LLC to the minor held by a custodian.

A gift of an interest in an LLC to minor is not limited to LLCs that hold real estate. Almost any interest in an LLC, corporation, or other type of entity can be given provided. The entity may own interests in other entities, brokerage accounts or other assets. One could even provide a minor an interest in an operating business (whether this is advisable should be discussed with an attorney and tax professional). The gift must be well documented. It is important that the operating agreement, shareholder agreement, or bylaws specifically acknowledge that the interest is held by a custodian for a minor.

By way of example, the custodian could convey assets to an LLC. In exchange, the LLC would issue a membership interest in the LLC to the custodian to hold for the minor. After the capital contribution, the LLC would acquire direct title to the assets and the custodian would hold a membership interest in the LLC as custodian in keeping with FUTMA. Neither FUTMA nor the LLC Act prohibits the issuance of membership interests to the custodian for a minor person. The transferred assets in the LLC would be managed by a controlling member or a manager other than the minor, usually the custodian or the child's parent(s). When the child reaches the age of 21, the custodian would transfer the membership interest to the minor who is now an adult.

This structure is legally viable and permissible under Florida law. Under Section 710.111 of FUTMA, custody over a minor's property is created when a transfer of an interest in property is made to a named custodian for the benefit of a minor. A membership interest in a Florida limited liability company is personal property pursuant to Section 605.0501 of the LLC Act. Accordingly, a custodian may properly hold a membership interest in an LLC as custodian for a minor.

Finally, and consistent with Section 710.123 of FUTMA, once the minor attains the age of majority, the custody of the interest in the LLC terminates and the custodian is required to assign and transfer the membership interest in the LLC to the minor. The LLC, under the management of the controlling member or manager, however, will continue the direct ownership interest in the assets even after the minor reaches the age of majority under FUTMA. The child will obtain all rights associated with the interest, which may include the right to vote the interest in the LLC or to otherwise participate in the LLC as a member.

While authorized if setup properly, this is a technical relationship that must be well documented. Accordingly, it is important that the relationship be governed by written documents (e.g., an operating agreement) between all the respective parties. This structure will not work by merely filing barebones articles of organization with the Florida Secretary of State. The attorneys at MacLean and Ema, P.A. consider these issues on a case by case basis and will advise you of all your options. Please call to discuss how the use of an LLC may be helpful to your situation.