# Trust UPDATE

January 2021

IN THIS ISSUE

**Estate planning**

Bob Dylan's solution to Prince's estate problem?

Estate tax collections rising

The 2021 estate planning numbers

COVID-19 tax questions

**Retirement planning**

The DIY pension

A plan for drawing down retirement savings?

# Bob Dylan's solution to Prince's estate problem?

One major conundrum with the federal estate tax is determining exactly the value to which the tax applies. For those who die with an estate smaller than $11.7 million in 2021, the question is unimportant, as that is the amount generally exempt from the federal estate tax. The heirs of those with larger estates will have to contend with a 40% tax on the values in excess of that figure.

If estates consisted solely of publicly traded stocks, bonds, and cash, finding the taxable value of the estate would be easy. Unfortunately, most larger estates include many assets that are very hard to value. The guideline in such cases is the answer to a tricky question: What would a willing buyer pay to a willing seller for the asset on the date of death, knowing only what could be known as of that date? Subsequent developments are not taken into account, as a rule. The opinions of experts will be required and a variety of methodologies employed to come up with an answer to an imponderable question.

The estate of pop star Prince provides an illustration of the sorts of disputes that may arise. Prince apparently died without having made a will or taken any other estate-planning steps. What's more, there were tricky questions about who his heirs would be. The estate's executor had to attend to those matters at the same time that an inventory of Prince's assets needed to be compiled and valued.

The executor reported a total value for Prince's estate of some $82 million. The IRS believes that his fortune was nearly double that, $163 million. If the IRS is correct, that would mean additional estate taxes of $32 million and a penalty of $6 million for the substantial understatement of the tax liability on the estate tax return. Details on how they differed are tabulated as "A partial list of the Prince estate tax deficiencies" below. The estate is taking the matter to the Tax Court.

When valuing real estate or small businesses, appraisers look for "comparables" to establish a baseline, then develop a rationale for applying premiums or discounts to the comparables based upon relevant factors. It will be most interesting to see who the appraisers will compare to the incomparable Prince, even to those who are not fans.

*Continued on next page*

## A partial list of the Prince estate tax deficiencies

($ millions)

| Item | Estate reported | IRS asserted |
|---|---|---|
| NPG Music Publishing LLC | $21.2 | $36.9 |
| Writer's share of musical compositions | $11.0 | $22.0 |
| Paisley Park residence | $5.1 | $7.6 |
| NPG Records | $19.4 | $46.5 |
| Prince's right to publicity | $3.2 | $6.2 |

Source: Tax Court filing of Estate of Prince R. Nelson

### *Bob Dylan's alternative?*

In early December the music world was startled to learn that Bob Dylan had sold the copyrights to virtually all of his music to Universal Music Publishing Group. Terms of the sale were not disclosed, but the price was estimated at $300 million in news reports. Fans protested that songs such as "Blowin' in the Wind" were priceless.

Was Dylan "selling out" with this transaction? He did not comment on the matter, but observers suggested that selling a hard-to-value asset before death is rather a demonstration of responsible financial stewardship. Here are the estate management problems that Dylan solved with this move:

- ***No arguments over values.*** When you have an actual willing buyer and seller for an asset, there is no need to employ experts to rationalize a hypothetical value.
- ***Liquidity for the estate.*** One of the problems for the Prince estate if they lose their Tax Court case will be coming up with the cash to pay the tax—the IRS does not accept future royalty interests in payment of current obligations. Dylan's estate should have access to ready cash if major tax payments are due.
- ***Flexibility for implementing lifetime wealth management strategies.*** Dylan may want to make transfers to his children or to trusts on their behalf. He may want to engage in philanthropy. With cash, such strategies are simpler to implement.

The downside to making a sale of an appreciated asset during life is that an income tax will have to be paid. If the asset is held until death, the tax basis is stepped up to fair market value, and so the tax on the capital gain may be largely eliminated.

Under the Songwriters Capital Gains Tax Equity Act enacted in 2006, Dylan's sale of his copyrights will be treated as a long-term gain, eligible for the preferential 20% tax rate. During the campaign, President-elect Biden suggested eliminating that tax preference for higher-income taxpayers. He also suggested scrapping the basis step-up rule at death. So those tax factors may also have motivated Bob Dylan to make the sale sooner rather than later.

### *What about your estate?*

More than 99% of families will never have to worry about the federal estate tax as the tax code stands today. That does not mean that estate planning is not important for ordinary people—it is vital. Here are some questions to ask yourself:

- Does the estate plan include an up-to-date will?
- Have family circumstances changed since the last will was executed?
- Has the composition of the estate changed significantly since the last will was executed?
- Is there an inventory of assets to guide the executor?
- Are beneficiary designations for life insurance and retirement plans up-to-date?
- Does the will include specific bequests of property that is no longer owned?
- Is there a health care directive?
- Does someone have a power of attorney?
- Should a living trust be considered for the owner of the estate?
- Does the estate plan take advantage of lifetime gifts?
- Which beneficiaries should receive their inheritance in trust?
- Who will be the trustee?
- If there are trusts, in what circumstances can the trust be invaded?
- Where will the estate planning documents be kept?

### *Choice of executor*

One more crucial question—who will be in charge of settling your estate? Has that person had experience in estate settlement? Are they good at tax preparation?

Estate settlement is one of our core competencies. We do this job and we do it well—we do it every day. Please call upon us to learn more. ☐

© 2021 M.A. Co. All rights reserved.

# The DIY pension

For many people planning to enter retirement, the trickiest part is the adjustment to no longer having a regular paycheck. Those who have an employer-provided pension may not have that concern, but for the rest the only recurring income source will be their Social Security monthly benefit. That is welcome, but the average benefit in 2021 is projected to be $18,500—hardly enough to live on. Even the maximum annual Social Security benefit of $37,776 will need to be supplemented.

What can someone who has no pension but does have substantial savings do to create a do-it-yourself steady retirement income like a pension?

## A plan for drawing down retirement savings?

In a June 2020 survey of people aged 50 to 75 who had a net worth of $100,000 or more, Kiplinger's Personal Finance magazine asked, "Do you have a plan for how you will draw down your retirement savings?" They responded:

Source: October 2020 Kiplinger's Personal Finance

### *Annuitize*

One approach for creating a steady income stream is the purchase of an immediate annuity. This shifts the risk of investment management and financial market volatility to the annuity seller, typically an insurance company. To get an estimate of how much monthly income can be purchased for a given lump sum payment, try https://www.immediateannuities.com. For example, a male at age 66 willing to invest $500,000 could expect an estimated $2,484 per month for life. The payments are lower for younger buyers, higher for older ones, because the payout period changes with age. For the same $500,000 a 70-year-old could receive $2,802, while a 62-year-old starting an early retirement would get $2,241.

Annuities can provide the peace of mind of a steady income, but they do have their downsides. At the moment, the biggest downside is that the current low interest rates reduce the size of the payment that an insurance company can promise to provide. A second potential problem is that most annuities do not include an inflation adjustment, as Social Security benefits have. Annuities that do increase for future inflation must offset that by offering lower benefits in the early years.

Another problem is that the annuity cannot be invaded if there is a sudden large financial need. Similarly, the annuity typically ends at death, so nothing is left for heirs.

Married couples may consider purchasing an annuity for two lives, so a surviving spouse will not be left without an income stream. Another option to consider is an annuity for life and a term certain, such as life and ten years. Should the annuitant die before ten years are up, the annuity continues to be paid to an heir until the ten years expires. The price of such expanded financial protection is a somewhat lower initial annuity. For the 66-year-old male, the monthly payment would fall by $53.

Although annuity payouts may seem high compared to, for example, the interest rates on FDIC-insured savings these days, it is well to remember that the payment is in significant part simply a return of principal.

### *The 4% rule*

In an ideal world, one would have saved enough for retirement so as to be able to live on interest and dividends, without touching the principal. Not nearly enough people live in that ideal reality.

A more realistic approach has been dubbed "the 4% rule." At the beginning of retirement, the retiree draws 4% from IRAs, 401(k)s, and other retirement savings. Each year after that, the withdrawal is increased by the amount of inflation. For example, $1 million of savings would provide $40,000 the first year. If inflation ran at 3% that year, the next year the withdrawal would be $41,200.

This rule has worked very well for past retirees, in that they did not outlive their retirement money. However, today we are in an ultra-low interest rate environment, and dividends are at low levels as well. Add in the economic uncertainty of the pandemic, and one begins to understand that the 4% rule is more guideline than law.

Still, this approach keeps the entire portfolio available in case of unexpected financial need. If no emergency develops before death, the remaining portfolio is available to heirs. According to a study done by the Employee Benefits Research Institute, those who began their retirement with $500,000 or more in savings had spent down an average of less than 12% of their capital 20 years later.

We can help with your retirement income planning. Please bring your questions to us at your convenience. ☐

## Estate tax collections rising

A recent study by the Congressional Research Service reports that the federal estate taxes are paid by just 0.06% of decedent's estates. As a revenue source, the federal transfer tax collections are so small they are lumped into "other revenue sources" in the OMB spreadsheets tracking where the money is coming from.

Still, more than $16 billion in federal estate and gift taxes were paid in 2019, and the projection for 2020 is over $20 billion. Collections rise steadily in the OMB projections, reaching $27.5 billion in 2025. Under current law, the federal estate tax exemption falls roughly in half in 2026, so transfer tax collections are poised to jump then, unless Congress takes action.

The biggest year for federal transfer tax revenue was 2000, when some $29 billion was collected, according to the OMB historical records. That would be about $45 billion in 2020 dollars.

For comparison, in 2019 the corporate income tax brought in $230 billion, and the individual income tax, the largest revenue source, was $1.71 trillion. Excise taxes were $99 billion.

## The 2021 estate planning numbers

In 2021, the lifetime exemption equivalent from the federal estate and gift tax rises to $11.7 million. Married couples have the potential to shelter $23.4 million from estate tax if both spouses die this year. If one spouse dies this year with an estate below the taxable threshold, the surviving spouse will be able to take advantage of the Deceased Spousal Unused Exclusion Amount in his or her own estate planning.

The annual gift tax exclusion will be unchanged at $15,000 per donee.

## COVID-19 tax questions

Since GoFundMe campaigns were launched in 2010, an estimated $9 billion has been raised from 50 million donors. The platform may have experienced additional growth in 2020 given the widespread financial hardship from the coronavirus pandemic.

Tax consequences? It depends.

There is no tax deduction for the donor to a GoFundMe campaign unless the donee is a tax-qualified charity, which is not the usual case. On the other hand, the money raised is not includable in income if it was a gift from a disinterested party.

IRS information letter 2016-0036 stated that crowdfunding revenues are generally includable in income unless they are gifts made out of detached generosity and without any quid pro quo. Loans that must be repaid, or capital contributed to an entity in exchange for an equity interest in the entity, similarly would not be taxable income. ☐

**Let us help you choose the best options for preserving your wealth.**

Utilizing life insurance, revocable living trusts, investment management accounts and more products, our Trust Division has a variety of options to help you preserve your assets for the next generation.

**For more information, call (844) 350-8512**