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Retire With More – Tax-Advantaged Business Sales

Tiffany T. House, CAP®, CEPA, FCEP, Gift Planning Institute, Tax & Estate Strategy

Editor's note: This article is an adaptation of the live webinar delivered by Tiffany House, in 2022. Her comments have been edited for clarity and length.

You can read the summary article here as part of the January 2023 Retirement InSight and Trends Newsletter, worth 1.0 CE when read in its entirety (after passing the online quiz.)

You may also choose to take the full length course Retire with More – Tax-Advantaged Business Sales for 1.0 hour continuing education (CE) credit.

By Tiffany T. House, CAP®, CEPA, FCEP, Gift Planning Institute and Tax & Estate Strategy

There are many tax-advantaged sale options. My goal is to help you understand how various planning tools apply to different corporate structures of businesses like S-Corp, C-Corp, and LLCs and for you to feel confident as an advisory team member when clients are ready to sell their businesses.

The Psychology of a Business Owner

Most business owners have leveraged their homes at least once, and 50 percent have done it three times or more. That means business owners are not risk averse, and it's hard to scare a business owner into taking action because they gamble daily on themselves and their ideas.

They also spend much time working *in* their business rather than *on* their business. This provides an excellent opportunity to have conversations with business owners years before when they might sell their business. Business owners also trust the numbers and do not like to be told what to do, even if they are paying for advice; as advisers, we need to consider this.

There's a $30 trillion opportunity as the most significant intergenerational wealth transfer is about to happen. The largest pool of wealth comes from these baby boomers; they own 40 percent of all small businesses. This will create an incredible shift as businesses need to be sold as baby boomers want to retire. Unfortunately, some of them need to do better planning and end up dying with their business, hurting the next generation.

The Exit Planning Institute studied business owners and asked them if they felt that a transition strategy was important for their future and their business. Ninety-nine percent of them agreed with that statement. However, 79 percent of owners had no written plan, 48 percent had yet to do any planning, and many had not thought about what they would do next. They also looked at the most trusted advisers in their transition teams. CPAs were the most trusted advisers, followed by Corporate Attorneys and the business owners' spouses. There's a real opportunity to work with these advisers to accomplish an effective business sale.

Business owners have often been mentored, which makes them more generous. Fidelity did a study, and they found that entrepreneurs gave 50 percent more than non-entrepreneurs when they gave to charity. Also, when they volunteered, they volunteered two or more hours per week than non-entrepreneurs.

All this creates a wonderful opportunity for those in the financial tax legal field to help business owners create what they want for the next phase of their life, their retirement. One thing to consider with business owners is that they are not like dogs – they do not want to be told what to do even if they're paying for advice – they are more like cats. If you want to advise business owners, think of them like cats and let them think that they are the ones generating the ideas and that you are there to support them.

Tax-Advantaged Business Sales and Other Assets

Below is a cheat sheet I created for tax-advantaged business sales.

Tax Advantaged Sales Strategies - Tools Matrix

		Type of Asset*				
Tax Strategies	AKA	S-Corp	C-Corp	LLC	Assets	
Donor Advised Fund	DAF	Yes	Yes	Yes	Yes	Charitable savings account that is easy to create and maintain. Types of assets accepted are dependent on the sponsoring nonprofit organization.
Private Foundation	PF	Yes	Yes	Yes	Yes	Federal regulation and self dealing rules must be followed. PF must distribute 5% yearly and can only deduct 30/20% of AGI.
Supporting Oraganization	SO	Yes	Yes	Yes	Yes	SO must support a 501c(3) and the supported 501(c)3 chooses the governing board. Usually best with $5M+ of assets.
Charitable Remainder Trust	CRT		Yes	Yes	Yes	Great tool for capital gains tax burden. Provides tax free sale, income for life from the whole asset, and income tax deduction for future gift. Can be used for portion of the asset.
Charitable Lead Trust	CLT	Yes - After the Sale	Yes - After the Sale	Yes - After the Sale	Yes - After the Sale	Great tool for estate tax burden. Can be used in life or at death. Works best in a low interest rate environment.
Grantor Charitable Lead Trust	G-CLT	Yes - After the Sale	Yes - After the Sale	Yes - After the Sale	Yes - After the Sale	Flexible tool for income tax planning. Could function as a self endowment and works best in low interest rate environment.
Charitable Stock Bailout	CSB		Yes			Requires very special circumstances. Could turn out negatively.
Opportunity Zones	OZ	Yes	Yes	Yes	Yes	Gains are re-invested. Defers capital gains and client can pull out basis in cash. Provides future nontaxable growth if held 10 years and criteria is met. Has extensive rules regulations.
1031 Exchange	1031				Yes	Re-invest in a like kind asset. Basis rolled into new investment.
Deferred Sales Trust or Intermediated Installment Sale Trust	DST /IIST	Yes	Yes	Yes	Yes	Allows an asset to be transferred to a Trust and defer the taxes. Installment note payments will be taxed as the client receives them. There is no IRS ruling on this strategy.
Employee Stock Ownership Plan	ESOP	Yes	Yes			There are ESOPs for both C and S Corporations that can provide very attractive tax benefits and employee have a sence of pride in ownership. They are complicated and combersome to do.
Qualified Small Business Stock (1202)	QSBS or 1202		Yes			Can provide a $10M federal tax exclusion for a C-Corp investor who qualifies under specific rules and guidelines. Must be original stock of less than $50M business and held over 5 years.

Darker colors indicate potentially stronger affinity.
*Consult with trusted Tax, Legal and Financial Advisors as needed.
*Tax Advantage Strategies often require an advisory team.
*UBTI can cause issues.

TAX & ESTATE STRATEGY
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On the left side of this chart are different tax strategies, most of which we will cover in this article. The next column over is AKA, or "Also Known As ." Then we have S-Corp, C-Corp, LLC, and assets.

I try to make it simple to understand what type of tools you can use in certain situations with different business structures. Some of the boxes are darker than others, meaning it's a little more relevant or easy to accomplish. If it's a lighter color, it might not be the strategy that I would go to first, or you might have to ensure that it is appropriately structured by someone who knows what they're doing, particularly with S-Corp stock.

Let's go into the structure of businesses. Seventy-three percent of all businesses which file with the IRS file as an S-Corp. An S-Corp is a pass-through entity for tax purposes, meaning that the owner of the S-Corp will pay taxes at their personal rate for anything that comes through the S-Corp. One thing to consider with S-Corporations is the unrelated business taxable income or UBTI, which can get in the way of some charitable planning tools and other planning tools.

If a charitable remainder trust has UBTI associated with it, it will be taxed at 100 percent. So, we do not put any UBTI assets, unrelated business taxable income assets, inside a charitable remainder trust. But we can use other tools like a supporting organization or a Donor-Advised fund.

C-Corps are taxed at a corporate level, and when the proceeds are paid out to the owners, they are taxed at their personal level. So, C-Corporation income is double-taxed.

LLCs (limited liability corporations) can choose how they are taxed; they can be taxed like an S-Corp, a C-Corp, or a disregarded entity if there's only one owner in the LLC.

Assets like land and buildings are taxed at capital gains tax rates and have a lower depreciation recapture rate of only 25 percent. Other assets can go up to your ordinary income tax rate. This is important to know when we're dealing with a sale of a business because sometimes it's going to be a stock sale, and sometimes it's going to be an asset sale.

Partnerships are also pass-through entities, but each partnership has different governing documents. If you're dealing with a partnership, you must go back to the governing documents and look at how it is structured inside the document to see what kind of planning strategies you can utilize. That is why you did not see Partnerships on my cheat sheet because you can only state clearly once you read each document.

Regarding stock sales versus asset sales: One thing that is looked over often by 75% of business owners is if they own an S-Corp, they think they can sell the stock, and they think it will be sold at capital gain taxes. Business owners and advisers must realize that buyers don't want to buy S-Corp stock. There are a few reasons; one is that a liability could still be attached to the business before the change of ownership. If you buy the stock of an S-Corporation and an employee feels they were wrongfully terminated, they could come back and sue the new owners. Or there could be a problem with vendors or customers as well.

Another reason buyers don't want to buy S-Corp stock is because they can get a step-up in basis by buying the assets instead. Many business owners are utilizing a 15-year depreciation schedule, and some are even doing accelerated depreciation on some of the assets within the business. If a buyer bought the stock, they would have to assume the same depreciation schedule. However, if they bought the S-Corp's assets, they could get a step-up of basis, which would benefit them for tax purposes.

Donor Advised Funds

Now we'll dive into the meat of this topic. We're going to go through some of the strategies on my cheat sheet, and I'll share with you some of the case studies that I worked on where this was a pertinent planning strategy tool.

A Donor-Advised fund is like a private charitable account where a person can set aside their charitable savings account and get the tax benefits upfront. It's taxed a lot like an outright gift to charity because, essentially, the Donor-Advised fund is a 501(c)(3). One of my favorite things about a Donor-Advised fund is that it's a great way to teach philanthropy to future generations.

Who is an ideal candidate for a Donor-Advised fund? It's usually someone who

- needs an immediate income tax deduction
- intends to leave a legacy

- has considered forming a family foundation
- is a high-income earner
- wants to include the family in charitable planning
- wants to give to multiple organizations and simplify the accounting, and
- desires anonymity in their giving.

You'll also see sometimes that people will bunch their gifts in one year utilizing a Donor-Advised fund. But it can be an excellent tool for anybody who is listed here as an ideal candidate, and they only have to have one of the attributes below.

I had a client who owned an insurance company with his father. The father was ready to sell, and a large national insurance company thought they were perfect for acquiring. It worked out well that the majority of the sale of this business, which was an S-Corp, was personal goodwill. This is great because personal goodwill is taxed at capital gains tax rates, whereas corporate goodwill is taxed at ordinary income tax rates.

We already had a good structure for how the business would be sold. However, this gentleman had had a bit of a rough go earlier in life where he had fallen onto a destructive path, so now he gave 10 percent of his income to charity. He necessarily wasn't religious; he didn't go to church, but every time he received a check for anything, he gave away 10 percent. So, we went ahead and did a Donor-Advised fund for him at the time of the sale so that he could get a big tax deduction upfront and then be able to fund his future charitable endeavors.

It all starts with choosing a sponsoring 501(c)(3). Fidelity Charity, Raymond James Charity, and other broker-dealers have put together their own Donor-Advised fund program. There are also the Community Foundation or other large nonprofits, and private organizations like the American Endowment or Charitable Solutions that have Donor-Advised programs. The type of asset being sold is how I choose who will the sponsoring 501(c)(3) for the Donor-Advised fund.

DONOR ADVISED FUND (DAF)

FEATURES, BENEFITS AND OBSTACLES

- Put Money away today (high tax year) and disperse it when and how you desire
  - **End of year planning strategy**
- All distributions must go to a qualified Charity
  - No scholarships unless done through 501c3
- Maintain control of how the assets are invested
- Assets grow tax-free compounding
- Could be used as a Private Endowment
- Brings family together to make philanthropic decisions
- "Forced" charitable inheritance
  - ***Teach children independent philanthropy***
- Some providers allow for complicated asset gifts that would be hard for a charity to accept
- **Can be used as the charitable beneficiary in a CRT and CLT**

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So, the donor gets to make their own little fund inside the sponsoring organization. They make that gift and get that tax deduction right up front. The nice thing about this, particularly with this gentleman and his father with the insurance company, is that he wrote checks to charities every month because he was constantly giving away 10 percent. His accountant now loves me because only one receipt needs to be provided, and that's the gift he made to the Donor-Advised funds. As the Donor-Advised fund pays out to charity at different time frames whenever the donor decides, there's no reporting necessary because they received the tax deduction upfront.

One of the other opportunities I like with Donor-Advised funds is to use them as an end of your planning strategy, as some people have a last-minute, "Oh shoot, I have a big tax liability coming up ." They can get that deduction this year and put their gifting into future years.

It is also a great way to teach children philanthropy. My husband and I have a Donor-Advised fund, and we ask our kids to grant from it twice a year. They have to research the charities. If you have any clients with children concerned about the direction their lives are heading, a Donor-Advised fund is a great way to help them guide future generations into the direction they might find more suitable for them.

Finally, one of my favorite things about a Donor-Advised fund because it can be used in conjunction with other charitable planning tools, and it can be the charitable beneficiary of the charitable remainder trust and a charitable lead trust.

Supporting Organizations

A Supporting Organization (SO) is a mix between a private foundation and its Donor-Advised fund. It has to support a 501(c)(3) organization or a class of 501(c)(3) organizations. A Supporting Organization is an excellent tool for complicated assets. An ideal candidate for a Supporting Organization is someone who is thinking of selling their business and wants higher adjusted gross income limits for gifting than they would be able to get from a private foundation. They want to maintain some control and don't want to pay capital gains taxes on the assets.

A woman I work with is in business with her two brothers; they specialize in alternative investments. They have a unique portfolio and will be selling four or five of their businesses worth about half a billion here within the next five years. The first asset we're working on is bouncy houses, and their warehouses are full of trampolines, blow-up things, and what-have-you that generate great cash flow. They are looking to sell this asset and then move into other businesses.

The sister wants to give to a charity that helps homeless people. She wants to buy bulk mattresses and donate them to an organization because she does not think the charity will manage the money properly or get a good deal on the mattresses. I spoke with her about putting one of their complicated assets into a Supporting Organization. Now she can designate a class of charity – it doesn't have to be one charity – of 501(c)(3) organizations. She could donate to charities that the local Community Foundation. You can make it very broad as to what 501(c)(3) you can support. My suggestion to her was to create the Supporting Organization with the LLC interest in one of the buildings inside the Supporting Organization. Then, she can liquidate them inside the tax-exempt entity and save taxes.

Supporting Organizations have received a bad name in the past. There are three types of Supporting Organizations, and Type III was overly used. The Pension Protection Act cracked down on it, and now Type III Supporting Organizations have similar rules to that of a private foundation and are much more scrutinized. However, Type I and II are not scrutinized and have higher adjusted gross income limits, meaning that you can give more each year to the Supporting Organization. It provides a great opportunity for complex assets like S-Corp stock.

A Supporting Organization is a great tool for complex assets; however, I usually only look at it when there are over $5 million. Other tools could be utilized instead, like a Donor-Advised fund or sometimes a Family Foundation.

Charitable Trusts

One of my favorite tools is Charitable Trusts. There are three kinds of Charitable Trusts, all of which have been in the tax code since 1969. The three types of Charitable Trusts apply to different tax problems.

1. The *Charitable Remainder Trust* is what I look to for capital gains tax issues. It can also help with income, estate taxes, and other taxes, including state taxes. But if you hear of capital gains taxes, your Charitable Remainder Trust is the go-to tool.

2. If there's an income tax issue, a Grantor-Charitable Lead Trust is the tool I suggest looking at first or with other tools that aren't charitable.

3. A *Charitable Lead Trust* or *Non-Grantor Charitable Trust* is a perfect tool for an estate tax issue. It's fabulous, and you can wipe out all estate taxes. It's easy to do, and as I mentioned, it's been in the tax code since 1969.

So, I see Charitable Trusts as the Swiss Army knife of planning. You do not have to have a charitable client necessarily to talk about some of these charitable trusts. In those cases, I'll call them Tax-exempt Trusts. I have talked to plenty of people who were not charitably minded or did not want to give their money to a charity; instead, they wanted to give it to their kids. I showed them some of the tax benefits and how they would end up with more by giving some.

Charitable Remainder Trust

The Charitable Remainder Trust (CRT) is for capital gains taxes, net investment income tax, state tax issues, and depreciation recapture can all be solved within a Charitable Remainder Trust. It needs to be more utilized by most.

Let's pretend we have an apple tree, and with this apple tree, we can take the asset, the apple tree, and put it into a Charitable Remainder Trust. The donors can act as trustees, fertilize it, grow it how they want and have a say over how the investments are managed. They're also able to get the apples or the income for life which makes them quite happy. At the end of life or end of term of years, their tree will be then transitioned over to a charity, and that provides some great tax benefits. The donor can get lifetime income, they get an income tax deduction upfront for their future gift of the tree, they get to save taxes now, and they get to nurture the tree as trustees.

An ideal candidate has a highly appreciated asset and accompanying capital gain on which they're concerned about paying capital gain taxes. They can also be considering selling a business, own rental properties, perhaps not charitably inclined, and would like to convert to a ROTH IRA or other tax-related concerns.

I have used a CRT very successfully with a ROTH IRA conversion for an IRA that was quite significant. We were able to do a Charitable Trust at the same time and utilize the tax deduction upfront for the ROTH conversion so that this client could convert to a ROTH without having to pay any of the taxes.

A couple from Minnesota had a plastics company. Minnesota has a very high-income tax rate state. They were ready for retirement and selling their C-Corp for $18 million. They wanted to ensure their son was cared for because he had been very influential in the business. He was a great employee, and they wanted to make sure that he received things from the sale. We set up trusts to be able to get assets outside of the estate and utilize the estate tax exemption. Their son (and a daughter) were given stock that was put into the trust so that assets could grow inside their trusts. Their kids ended up with a good majority of the business, and they were quite happy at the time of the sale.

Then we put $5 million also into a Charitable Remainder Trust from which this couple could get income for life. They were very charitable, so they were excited about supporting their charities in the future. The tax savings was the kicker to help them decide to do a Charitable Remainder Trust.

As an example, we're going to look at the sale of a $2 million-dollar business just for the simplicity of numbers. I rarely put 100 percent of an asset into a planning strategy, such as with the plastics company, where we utilized some of their estate tax exemption and gave assets to their kids, which grew over time before they sold it. We also did a Charitable Remainder Trust for only $5 million because we wanted to make sure that we utilized the deduction the best we could while allowing them to keep money outside these planning tools.

With this example, we will split the $2 million-dollar business sale in half, and we're only going to put one million dollars into a Charitable Remainder Trust. We'll allocate half of the business interest – this is a business that has no tax basis as the founder started it – and we'll title that and put it into a Charitable Remainder Trust. When we do this, there are no taxes, which allows us – in this example – $288,000 in tax savings. Where did I get that number? The federal capital gains tax rate

is 20 percent, we have the 3.8% Medicare or net investment income tax, and an estimated 5 percent state tax, totaling 28.8 percent. If they put half of their business into the Charitable Remainder Trust, they save $288,000.

Upon the death of the second donor, the funds left over benefit charity, or it could also fund their own Donor-Advised fund. They can navigate it from the grave and leave their kids in charge of the Donor-Advised fund, instructing them to have a family meeting once a year to determine who will get funds from the Donor-Advised fund.

Because of their future gift to the charity or the Donor-Advised fund, this 65-year-old couple could get a $275,000 income tax deduction upfront, which greatly benefited them. They wanted to take a six percent income from the trust, so the first year's distribution was $60,000 – this was a unitrust, so the income did fluctuate – but if they lived their joint life expectancy of 30 years, they would have received $2 million of income.

What if leaving something to the kids is your client's most important objective in their planning? You can buy a $1 million life insurance policy and supplement or replace the asset. For example, you can make ten years of payments of $30,000, so $300,000, and we'll take that out of the income paid to the donors, which makes their lifetime income $1.7 million after the life insurance premiums. The kids still get one million dollars of inheritance, and the charity or Donor-Advised fund gets $1.3 million (the initial $1 million plus $300,000 in life insurance premiums).

But the neat thing is that income tax deduction of $275,000. If you had that taxed at a 40 percent income tax bracket, the owners are saving $110,000 that they could invest and use for the future. When you add up the capital gains tax savings of $288,000, that's $398,000 of tax savings. These tax savings can then be utilized to sell the other portion of the business.

I will often do half of an asset or less; sometimes, it's only for about 25 percent. It depends on the taxes that can be saved and which deductions can be utilized. So often, we do not determine how much is going into the CRT until we've talked to the client's accountant, figured out their tax liability, and what we want to offset with that income tax deduction.

Another nice thing about this tool is if you can't use it all the first year – the adjusted gross income limit for putting funds into a Charitable Remainder Trust is 30 percent – if you can't utilize that deduction the first year you can use it in future years up to six (first year plus five). So, in this example, we were able to not gift $288,000 to the IRS but instead keep the assets growing tax-free inside the trust. This income tax deduction can be used this year or in future years, and it's great for a ROTH IRA conversion. It also helps if you have estate tax issues; you pull that asset outside the estate for estate taxes, which can provide some asset protection.

We also need to compare this to what would happen if we did not use a trust. In this example, we're only going to take half of the asset we put in the trust or $1 million of a business with no basis. We put those funds into an investment portfolio at the time of sale and pay the $288,000 tax to the IRS. We still take the same six percent annual income distribution to the owners, but now from a smaller asset, so they only receive $42,000 a year compared to $60,000 in our previous example. This reduces their lifetime income for the same life expectancy to about $1.25 million.

The kids will get an inheritance of around $850,000, which is less than our previous examples because there was less in the investment portfolio in the first place. Charity gets nothing, and the IRS is the big winner because there is no income tax deduction, and the capital gains tax is paid.

Let's compare the sale of a business with no trust and the sale of a business utilizing a Charitable Remainder Trust. There can be $1.25 million without utilizing a trust or $1.7 million when utilizing a Charitable Remainder Trust, even after we paid life insurance premiums. The inheritance went from $850,000 with no CRT to $1 million with the CRT because of the life insurance purchased. Charity became the big winner as it was $0 with no CRT and $1.3 million with it. There are only income tax savings with utilizing a Charitable Trust. Still, the income tax savings for using the Charitable Trust, if you take the $275,000 deduction that we discussed earlier and tax it at about a 40 percent tax rate, means that they had $110,000 more in their pocket.

If we invest the $110,000 income tax saved over the same life expectancy of 30 years, that's over $800,000. In sum, the total benefit of selling straight-out is $2.1 million to the family, but when we use a Charitable Remainder Trust, the total benefit is $4.8 million. You can say, "Okay, great, charity got $1.3 million of that." However, when you look at it, the family still came out $1.5 million ahead on $1 million in assets by utilizing a Charitable Remainder Trust.

The only real threat with the Charitable Remainder Trust is if the donors don't live to life expectancy. That is why you can also do a Charitable Remainder Trust with a term of years. Recent clients were selling a dermatology practice and said, "We don't want to pay taxes; we give to charity, but that's not our main motivation. We have two sons we like and one son we don't. We want to go ahead and give income to two of the kids and leave the third son out."

So, we did a Charitable Remainder Trust with them that included 20 years of income for the two sons they liked. That did make their income tax deduction less because less was going to charity, but they were less concerned about that. They wanted the income; they wanted their kids to receive income, and they did not want to pay taxes on that sale. So, the CRT was a great way to create a legacy and accomplish tax-free compounding growth.

Most Charitable Remainder Trusts can be invested just like a typical stock portfolio and other investments, which most financial advisers will also suggest. The assets inside the Charitable Trust are growing tax-free, so they can be utilized to accomplish more strategy versus a portfolio that isn't inside the trust and, therefore, will be taxed whenever there are changes and diversification in that portfolio.

An important consideration is life expectancy. People who give to charity live longer than those who don't. I have done over 30 charitable trusts, and no one has ever died short of their life expectancy; if anything, they live past their life expectancy.

Another important consideration is that a Charitable Remainder Trust works best in a high-interest rate environment. It uses something called the AFR 7520 rate. The rate for October 2022 was 4.0, November 2022 was 4.8, and December 2022 was 5.2. The higher the interest rate or the AFR rate, the more that deduction will be and the higher their deduction will be upfront for their gift.

The CRT is an excellent tool for real estate, raw land, publicly traded securities, closely held businesses, apartment complexes, and any asset that is highly appreciated. It's preferable without debt, so you need to manage the debt before putting it into the Charitable Trust, but third-party nonprofits will help you with that. They will go ahead and manage the debt so that you can put the property or assets inside the trust.

Charitable Lead Trust

The Charitable Lead Trust (CLT) was made famous by Jackie Onassis Kennedy. With the Charitable Lead Trust, rather than giving the apples (income) back to the donor, we give the apples (income) to charity. Because we're giving the income to charity, we can transfer the tree intact to the next generation. If we can do the CLT long enough, we can completely mitigate estate taxes.

The CLT is for any family

- concerned about estate taxes
- is charitably inclined
- cares about living a financial legacy to heirs and society, and
- wants to leave an inheritance to the next generation estate tax-free.

A CLT can be set up in life or at death. It is a great opportunity for those who know that they're going to have to pay some estate taxes; to do the planning now and have it come about in the future.

For example, let's say we have a $10 million asset. With a CLT, we are just putting a wrapper around the asset – like "Saran Wrap" – and then we'll take income out.

The income of six percent a year is paid annually to charities or over $10 million over the 18 years of this trust. Because of this, we can zero out estate tax liability or create $4 million in estate tax savings. If the trust earns seven percent or eight percent, that $10 million can grow and come out entirely estate tax-free. It's a great way to transfer assets to the next generation, and as I mentioned, it can be set up in life or death, but there are no adjusted gross income limits for it, so you do not have to worry about doing it in life.

Grantor Charitable Lead Trust

A Grantor Charitable Lead Trust (G-CLT) is the same concept but for clients with

- an income tax issue
- who are charitably inclined
- who care about leaving a financial legacy to heirs and society
- who need year-end tax planning, and
- who would like to convert to a ROTH IRA.

For example, a grantor puts $800,000 into a G-CLT trust (we put the same wrapper of the trust). We can determine the term of years (say a 10-year term), and they can get the $800,000 out at the end, plus or minus any growth. That allows them to give money to charities, say 5 percent a year for charity, so $400,000 will go into their Donor-Advised fund, which will give them an upfront income tax deduction for that future gift. So, the donor will get the $800,000 back after the term of years, but they got that large income tax deduction upfront for their giving.

That is a great tool to utilize for end-of-year tax planning when someone sold or did something, and they were not paying attention to the taxes and don't want to pay the taxes, they can get that upfront deduction the year that they go ahead and do this. So in this example, the G-CLT provided a $175,000 tax break in the 45 percent tax bracket.

One thing to consider is that a donor still gets to be a trustee, so they have to say over how the assets are invested, but we have adjusted gross income limits here of 30 percent, and there is something called the phantom tax liability. Any growth inside the trust does have to be paid by the donor each year. So, something to consider when looking at that.

Here's a quick difference between a G-CLT and a Non-Grantor style Trust. A G-CLT means the client will get the asset back; in both cases, the charity will get the income, and in a Non-Grantor trust, the kids will get the asset. So, in a G-CLT, the donor gets to keep the tree, gets the income tax deduction upfront, and is responsible for phantom taxes. On a Non-Grantor Trust or just straight-out for estate tax purposes, the donor gets to give the tree to heirs; they do not get an income tax deduction, they only avoid estate tax, and there are no adjusted gross income limits. There is also something called a Super CLAT that combines the two that can be a good tool for complicated situations.

Other Tax-Advantaged Business Sale Options

Opportunity Zones are awesome. They're better than a 1031 exchange. The Tax Cuts and Jobs Act of 2017 created these zones across the country where people can only take the gains. That's the beautiful part about an Opportunity Zone; you must take your gains and invest them into an Opportunity Zone. The Opportunity Zone

must fulfill certain obligations by the government; it's a little tricky, and there's a lot to it. I recommend utilizing a third party who is making the investment, and your clients can then invest inside those already structured investments.

The client gets to defer taxes when they invest in Opportunity Zones, and they get to defer the capital gains until the tax year 2026, meaning they don't have to pay it until 2027. They need to maintain the investment for ten years, and all growth over those ten years comes tax-free.

Key Takeaways

There are great opportunities for all involved with business sales. The thing to remember is that you need to start the conversation. You're not on your own; it takes a team. Please utilize the cheat sheet as a guide for talking to your clients.

The tool that you utilize depends on how the business is structured. Remember that business owners are cats, not dogs, so don't expect them to do what they're told. Have them follow the laser pointer to where you want them to go. Remember that you're not alone, and it's not as complex as it seems.

This was a presentation that could change your perspective on Tax-Advantaged Business Sales. Here are some additional resources.

- Exit Planning Institute State of Owner Readiness Study: https://exit-planning-institute.org/state-of-owner-readiness/
- Fidelity Entrepreneurs as Philanthropists: https://www.fidelitycharitable.org/articles/key-insights-into-entrepreneurs-as-philanthropists.html
- Forbes Baby Boomers: https://www.forbes.com/sites/markhall/2022/01/25/unsexy-but-thriving-businesses-the-hidden-opportunity-gifted-to-us-by-baby-boomers/?sh=142aa70e4620
- JP Morgan $30 Trillion Opportunity: https://www.openinvest.com/articles-insights/how-to-prepare-for-the-great-wealth-transfer-to-millennials
- Tax-Estate.com
- GiftPlanningInstitute.com
- ceplan.com

Retire with More – Tax-Advantaged Business Sales – Tiffany House

About Tiffany T. House, CAP®, CEPA, FCEP, Gift Planning Institute and Tax & Estate Strategy

Tiffany House, CAP®, CEPA, FCEP, is a tax, estate, and charitable strategist. She works as a consultant with families and helps guide them through intricate and essential situations including transitioning a business, planning philanthropy, values-based estate planning, and tax concerns. She works as a liaison with the advisory team to enhance efficiency, provide a comprehensive overview of opportunities, and ensure that the client's best interests are always first.

Being an active member of the community is important to Tiffany. She is the Past President of *Planned Giving Round Table of Arizona* (PGRT), President of *Check for a Lump!* and a board member of *Junior Achievement of Arizona*. She has served on other boards and enjoys being an advisory board member for many organizations. She is a Member of the *Arizona State University (ASU) President's Club*, has participated in the *Entrepreneurs Organization (EO)* and is actively engaged in personal development with *Landmark*. She mentors with the *Arizona Community Foundation's Endowment Building Initiative* (AEBI) and is a graduate of *Scottsdale Leadership* Class 31.

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Helping Clients Provide for Their Child and Protect Their Retirement with Special Needs Planning – Trusts, Benefits and ABLE

Derek Graham, Partner, Resch, Root, Philipps & Graham, LLC

Editor's note: This article is an adaptation of the live webinar delivered by Derek Graham, in 2022. His comments have been edited for clarity and length.

You can read the summary article here as part of the January 2023 Retirement InSight and Trends Newsletter, worth 1.0 CE when read in its entirety (after passing the online quiz.)

You may also choose to take the full length course Helping Clients Provide for Their Child and Protect Their Retirement with Special Needs Planning – Trusts, Benefits and ABLE
for 1.0 hour continuing education (CE) credit.

By Derek Graham, Partner, Resch, Root, Philipps & Graham, LLC

My business partner and I teach a class at Ohio State. In this class, we talk about a triangle of services in financial planning. The bottom of the triangle is what everyone expects from their financial planner, and the top of the triangle is less-encountered issues. When financial planners can spot issues and recognize important topics at the top of the triangle, they really stand out. Those are the financial planners they will tell their neighbors about, which they will bring up in a dinner conversation. In this article, we will cover the top-of-the-triangle issues you will not encounter on a day-to-day basis.

This article will identify some of the various government benefits available to persons with developmental disabilities. There are a lot, and one of the challenges is that government benefits vary from state to state, but overarching themes are valid in every state.

We'll cover how a child with a developmental disability may be impacted when a parent elects to draw Social Security benefits. There is much information about when to draw Social Security, how much you will draw, and the cost/benefit analysis of drawing at certain ages. One of those top-of-the-triangle issues is when financial planners recognize what it does for your entire family, including your adult child with a developmental disability. This will separate them from other planners and it will impact my daughter with Down syndrome when I retire someday.

We will also identify strategies used to protect eligibility for these benefits. Parents of children with developmental disabilities are going to become advocates. The system requires this of them, and their families require this of them. Understanding how to get those benefits is important. Still, it is just as important to understand how to protect eligibility, making sure that the parents or the parents' death or something of that nature does not then mess up those very things that parents spent their lifetime advocating to obtain for their loved one.

What benefits are available for persons with developmental disabilities?

I had been an attorney for five years when my wife and I had our first child. When my daughter was born, she had some medical issues. She was in the hospital for quite a while and has been back many times since. I will never forget, on day three or four of her life, being handed all these packets by hospital social workers who gave me information about things like Medicaid, SSI, and other government benefits.

I thought, "Surely, I don't qualify for any of this stuff, and why do I care about this? We have health insurance." I remember throwing the packets of information away. I also remember being confused about why they gave them to me and whether I did something wrong by throwing them away in a huff.

Parents and families who have loved ones with developmental disabilities have a lot to learn. The more you can help them, the more it will make you a top-of-the-triangle planner remembered and talked about amongst social circles. More importantly, you will be doing a great service for your client.

Your clients and families who have a loved one, a sibling, a child, or a person in their life with a developmental disability, live in what I call the "one percent." Many things about my daughter's life that have happened to her from a medical or social standpoint will happen to less than one percent of the people alive. Your clients and families will naturally do things differently, such as gravitating to and becoming friends with other individuals or families with loved ones with developmental disabilities. But when it happens over and over, it compounds, and you start to feel like you live in the one percent.

The uncertainties for parents of developmentally disabled children

My wife and I have a joke in our house of, "That's life in the one percent." It's true. You wake up one day, and you learn something new from a medical standpoint or even a social standpoint that you never saw coming, and it changes your entire day. This makes parents and families with loved ones with developmental disabilities significantly more risk averse. With my other two daughters, if you ask if they can engage in an activity and there is a 99 percent chance that they will be fine, my first thought is, "Sure, go do it. Have fun." With Megan, my daughter with Down syndrome, even if there is a 99 percent chance that she will be fine, in my mind, you have just identified exactly what will go wrong. Keep this in mind when dealing with families and clients with loved ones with developmental disabilities.

There are very few things that will confuse and bewilder a young family who has a child with a developmental disability more than trying to picture what adulthood will be like. When any child is a baby, you do not know what they will grow up to be. You do not know what profession they will do, but you picture the opportunities available to them. You have a picture of how you think life will go for them, and a lot of that is shaped by how your life has gone. When I meet with families with a loved one with a developmental disability, one of the common themes that run throughout all these families (which will certainly be true for your client) is that they do not know what adulthood will be like. Because I have a daughter with Down syndrome, I have sometimes wondered if that means she will live with me for her entire life.

Does this mean that her adulthood is going to be significantly more expensive?

Do I have to save substantially more money and stop going on vacations because I have a child with a developmental disability that I need to pay for her entire life, and then leave more money for her to pay for all these expenses when I am gone? She will not have the same earning potential as my other children. All these things flash through your head. When dealing with clients who have loved ones with developmental disabilities, understand that imagining adulthood for their child will be a mystery to them. It is hard to picture what life will be like for them when their son or daughter is 25 or 30 because they don't know their capabilities.

It is also true because you do not know what resources will be available to them. There is benefit confusion. Families with loved ones with developmental disabilities are, in most states, going to be provided services through a county Board of Developmental Disabilities or some government agency that is there to provide social work and care coordination and to help them through life.

They will almost always be offered opportunities to learn about different benefits. However, it is tough when you have a sixth, seventh, or eighth-grade kid and that child has a developmental disability. You know that you need a special needs estate plan, and you have heard about that before. You have heard about Social Security, and you know that people might get Social Security, and you probably know other families who are getting Social Security. You might know another family who is not getting Social Security. You have heard people talk about Medicaid. I have health insurance through my employment, so what is the big deal about Medicaid? Do I really need to be concerned with this?

A Rubik's cube is analogous to what it is like to be a parent of a child with a developmental disability. You know there is a red, blue, and white side, but you do not know how to piece it all together. You know that at some point in your child's life, they will need Social Security benefits, or they may be entitled to Social Security benefits. You know that they will probably need Medicaid, but you do not know why or when. Whoever named the various benefit programs certainly compounded the problem. We have SSI and SSD, two very different programs. We have Medicaid, and we have Medicare, two very different programs. This confuses families.

Then there is the need for advocacy. Parents who have loved ones with developmental disabilities and siblings of those with developmental disabilities will become advocates. They might not naturally be predisposed to be an advocate, but they will have to. Families learn this as they go through life with a loved one with a developmental disability. Like it or not, it is a role they will have to take on; they must step up and advocate in that individual's life. Part of being an advocate is trying to help find information. Often, parents are just looking for someone who can provide a clear answer. They don't need someone to come in and change the world; they need someone to answer the basic questions in a way that they understand.

After the dust settled and we passed some major surgeries and things of that nature, I knew I needed a special needs estate plan. But I did not know what a special needs estate plan was, and frankly, I could not have told you why I needed a special needs estate plan. So, I asked different attorneys that I knew who did estate planning. I quickly found that you can ask the attorneys who "specialize" in special needs estate planning, and you will get different answers as to what exactly it means and how it works. There is a lot of incorrect information out there. So there is a need for advocacy, and often being an advocate is just getting the correct information. This is where you, as an advisor, come in because you can provide clear, concise answers or direction as to where to get the answers that will make all the difference in the world to your clients.

A Developmental Disabilities Benefits Matrix

When I meet with families, I start with the benefits matrix. This graphic, I find, goes a long way toward solving some of the confusion.

UNCERTANTIES FOR PARENTS

1. One Percent Rule (1%)
2. Mystery of Adulthood
3. Benefit Confusion – Rubik's Cube Effect
4. Need for Advocacy

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Families hear about these terms but do not understand what they mean and when they become applicable. I will refer to this benefits matrix a few more times.

Medicaid for people with developmental disabilities

We'll start by talking about Medicaid. Medicaid is a federal program, and many people think Medicaid is for someone who does not have private health insurance. Medicaid has been made more confusing in recent years by "expansion Medicaid," a much broader version of Medicaid. You need to know that your state, wherever you are, has a state Medicaid plan. Within that plan, a particular type of Medicaid is designated for people aged, blind, and disabled.

The Medicaid coverage available for persons with developmental disabilities is often different. It is certainly very different here in Ohio, and it is different in most of your states as well. Compare that with SSI, which is Supplemental Security Income. This is another program we will address, and this support is for aged, blind, and disabled persons. It is not a Social Security trust or retirement benefit, but a program administered by the Social Security Administration. The SS stands for Supplemental Security and is a line item on the federal budget. These two programs will be most families' first step into means-tested programs. Through one of these programs, families generally first learn of means-tested programs and their availability.

The federal government started Medicaid in 1965. While working on the legislation, many states asked for help covering the cost of institutionalization. This word makes the skin crawl of a parent of a loved one with a developmental disability. Institutionalization was the reality in 1965 because, at the time, Medicaid paid for two things: the health care of persons with developmental disabilities and placement in a 24/7 facility, or an institution.

The federal government started allocating this federal money to the states to help pay for the cost of some of these institutions. They did what the federal government often does; they sent regulators in to see how the money was being spent. Fast forward decades, and fortunately, the institutions closed. What this left was a federal program that could be used to pay for the health care and the health component of the aged, blind, and disabled. It could also be used to pay for institutionalization. So, even though we did not have those brick-and-mortar institutions that, in large part had closed, we still had facilities that were 24/7 facilities. In Ohio, we called them intermediate or long-term care facilities for a person with a developmental disability. But the only way to tap into Medicaid at the federal level was to qualify by placement in that 24/7 facility.

By 1981 the government realized that it was expensive to pay for the 24/7 care of a person in a facility. Wouldn't it be cheaper for the government if, instead of paying for 24/7 care in a facility, families were given a fraction of the cost of the 24/7 facility to pay for some extra support and keep their loved ones living independently in the community? This was the birth of Medicaid waivers; they waived the requirement that their loved one lives in a 24/7 facility.

Medicaid waivers created a funding stream that could be used to pay for things like homemaker personal care, home modifications, transportation, or job coaching. It paid for things that promoted independence. Knowing what a Medicaid waiver is will separate you from other advisors. Medicaid waivers are called something different in just about every state. In Ohio, they are called Medicaid waivers, and in most states, they have a close name to Medicaid waivers, but there might be a word or two added to the beginning or the end of that term. Understanding the history of Medicaid and what a Medicaid waiver is important to families with a loved one with a developmental disability,

Supplemental Security Income (SSI) for people with developmental disabilities

Supplemental Security Income is the first step into a means-tested program for most people who have a loved one with a developmental disability. Eligibility for this is impacted by various circumstances and needs when the individual is a minor.

Take my family, for example. I have three daughters; Megan, my daughter with Down syndrome, is in the eighth grade. Megan does not have Medicaid right now, nor does she have a Medicaid waiver, and she does not meet the criteria or need for having those programs right now. When she turns 18, though, she will meet the criteria for SSI. Most individuals get SSI when they turn 18. In most states, when you become eligible for SSI, you will automatically become eligible for Medicaid. Families can get SSI while the child is still a minor, but while the child is a minor, the parent's income and assets count towards eligibility.

On Megan's 18th birthday, she will still live in my house. I will still pay most of her expenses, but her income and assets will be evaluated regarding whether she qualifies for SSI. My assets and income will not impact her eligibility, and my wife's assets and income will not impact her eligibility.

An eighteenth birthday should always be a red flag when you have a client with a child with a developmental disability because many things happen from a timeline standpoint with that 18th birthday: 1. That person needs to apply for SSI. 2. Neither the parent's income nor assets matter. 3. The application process is very

frustrating, so find a resource that can help families apply for SSI. You will not make that referral very often, but it will be much appreciated when you do. While families can do it on their own, it is very difficult. . It is not something anyone is ever going to get rich doing. But it is a great service you can provide to people in terms of helping them to become eligible for these programs.

The full monthly SSI benefit for 2022 is $841. If you are married, the maximum benefit for a married couple is $1,261. The payment will be reduced if the parent is providing in-kind support because SSI is intended to, at its core, pay for food, shelter, and clothing.

So if mom and dad continue to provide food, shelter, and clothing, then Social Security will reduce the amount of SSI they pay their child. The parents must understand that their ongoing free provision of food, shelter, and clothing will impact the SSI amount that their child will receive. There are lots of ways that you can maximize that amount. And there are many reasons, as a parent, why you are doing the right thing to charge a fee or an annual expense contribution to your loved one with a developmental disability to maximize the SSI amount.

Families ask if their loved one can work while on SSI. Employment is always good for a loved one with a developmental disability. There are some nuance situations where I tell families they are better off from a strict dollar and cents standpoint to not take a particular job. But employment will affect what their child receives from SSI. There are a couple of exclusions. The first $85 is excluded from income. There is also a much larger student-earned income exclusion. If you are a student under the age of 22, you can earn more income. SSI will be reduced by 50 cents for every dollar that you earn. For example, if you earn $285 every month, they will exclude the first $85, and then they will reduce your SSI benefit by $100 because you have $200 of income over and above the general exclusion.

Going back in my matrix, you see SSI, Medicaid, and Medicaid waivers are tied directly to the individual's eligibility. SSI and Medicaid are entitlement programs, meaning you will get them if you are eligible for them. A Medicaid waiver is not an entitlement program; even if you are eligible, you might not get it. This is where you have to be an advocate and show need. Every state has slightly different criteria for assessing whom to give waivers.

Social Security Disability (SSD), or Title 2 benefit, is at the bottom of the matrix. Social Security replaces income when a worker retires, dies, or becomes disabled. SSD comes from the Social Security Trust Fund. Childhood disability benefits, also known as Disabled Adult Child benefits, are known by about 20 other acronyms.

For example, 20 years from now I will be 62 years old. Twenty years from now, Megan will be age 33. Say I decide to retire. My retirement at age 62 will impact Megan if I choose to draw Social Security. Most financial planners recommend waiting until the last possible moment to draw Social Security. However, the math is different when you have a child with a developmental disability. A top-of-the-triangle financial planner will recognize that for a client who starts drawing Social Security and has a child with Down syndrome, means the child should switch to Adult Disabled Child Benefits.

For example, say I retire at age 62 with my benefit at $2,258 a month. If I wait until full retirement age, I will collect $3,321 a month. That's a big difference. If I wait until age 70, I could receive $4,163 a month. There are many reasons why I would be much better off waiting until age 70 to retire if I do not need the money.

But let's factor Megan into this. If I retire at age 62, yes, I will only get $2,258 a month, but because I retired, Megan will get that Adult Disabled Child Benefit or Childhood Disability Benefit. Her benefit amount will be 50 percent of my retirement benefit at my full retirement age or 50 percent of the $3,321 a month. Keep in mind that the SSI goes away ($841/month), but she will now have a monthly benefit of $1660.50. Am I better off retiring at 62? No, but when I retire, this is absolutely information I need to factor in.

Two years after Megan is eligible for Adult Disabled Child Benefit or Disabled Adult Child Benefit, she will get Medicare. Megan may have started adulthood receiving SSI and Medicaid, so she might have Medicaid paying for health insurance and SSI as her income stream. She hopefully has a Medicaid waiver that has people coming into the home, helping her with transportation to work and job coaching, helping her with everything from laundry to meal planning.

When I retire, the SSI goes away, and she receives SSD, which in most situations, will be a much larger amount. Two years later, Medicare will become her primary health insurance. Anyone who has ever had Medicare knows Medicare is not free, and it can get expensive. In the Medicaid plan of most states, they have what is called a Medicare premium assistance program. If I am on Medicare and have a developmental disability, Medicare will be my primary health insurance, and Medicaid will be secondary. Medicaid will pay the cost associated with Medicare.

In sum, programs on the top part of the benefits matrix box are where eligibility is tied to the individual, and we want to protect that. Benefits at the top of the box are also means-tested, meaning we must protect the person's eligibility. Benefits in the bottom half of the box (the adult disabled child SSD benefits) are not means-tested. Megan could still have Medicare, but if she has $100,000 in the bank, she will not be getting Medicaid.

Protecting eligibility

Does your client have the right plan to protect eligibility? Why plan? If you fail to plan, you are planning to fail.

Every single person has an estate plan. They either have the estate plan that they have created for themselves, or they have the estate plan that the government has created for them. When you have a child with a developmental disability, the estate plan that the government has created for you does not work because it will render your child ineligible for some of the programs you spend your life advocating for your child to get. The last thing we want is for mom or dad's death to mess up eligibility for a child's benefit. That is why it is important to have the right plan.

Why have a trust for your developmentally disabled child?

A trust is a basket. When you sign a trust agreement, you sign a document that creates a basket. Either during your life or upon your death, we will make sure assets go into that basket in a way that does not go through what Ohio calls the probate process. States have different processes where the government oversees assets passing from generation to generation. We want to keep the government out of your estate plan to the greatest extent possible.

From a glance across the national landscape and having had trusts we have prepared here reviewed by attorneys in other states, certain nuances differ in every state. Having that trust reviewed by an attorney licensed in your state is important, and many laws carry over from state to state.

In estate planning, there is a difference between first-party and third-party money.

First-party money is that which legally belongs to a person with a developmental disability. With my family again as an example, money that legally belongs to Megan is first-party money. My money, my retirement account, my life insurance, my checking and savings, my house, and my car is third-party money to Megan because she does not legally own it. I am alive, and my wife is alive; we own that money. While you cannot completely disinherit a minor child, in large part, you can, and there is nothing that legally requires me to give that money to Megan upon my passing, with some exceptions. First-party and third-party money will be subject to different rules in most circumstances. We can protect third-party money in a way that we do not have in terms of protecting first-party money.

Let's start by talking about third-party assets, or those assets that belong to mom, dad, or even a grandparent. We see this all the time. Grandma and Grandpa did their estate plan 20 years ago. They created a will that says that upon our death, each grandkid gets $10,000. In Ohio, that transfer of ownership takes place upon Grandma and Grandpa's death, even though the grandchild might not get that money for several months, depending on the court process. At that point, the money goes from being third-party money to first-party money because their will says it goes to their grandkids.

Parents, grandparents, concerned friends, or family must act while the money is a third-party asset. Once it becomes a first-party asset, it is very difficult and rare to pull it back and protect it as though it were a third-party asset. We want to work within the third-party asset rules, not the first-party asset rules to the greatest extent we can.

This is why we use things like a third-party discretionary trust. A third-party discretionary trust is, in my opinion, the best planning tool for a family or a mom and dad who have a loved one with a developmental disability. Again, this is subject to nuances of state law. So in your state, you would want to talk to an estate planning attorney who has experience doing estate planning for persons with developmental disabilities, experience doing developmental disability law, and understands Medicaid and the implications.

My wife and I have created a basket with our third-party discretionary trust. On our death, the inheritance we want for Megan's benefit will go right into that basket. Once it is in that basket, that money can grow and be used as needed. There are pretty broad rules on what it can be used for, so if she wants to go on vacation with her sisters, she can, and the trust can help pay for that. If she needs a little bit of help with certain expenses in life, the trust is there to pay for that. It is a safety net. As a parent, we want to build that safety net for our children to use when we are gone, which is what this basket provides.

Someday when Megan dies, whatever money is left in that third-party discretionary trust will be used to pay for her funeral, burial, and things of that nature. Once those expenses are paid, any money left will go to my other two daughters, my grandkids, or the charity I pick. But ultimately, I have decided – as the person making the trust – where the money will go; I can do that when it is third-party money, and I cannot do that when it is first-party money.

Many attorneys confuse a third-party trust with a special needs one. Attorneys will create a third-party discretionary trust and slap a special needs trust on top of it, and these are two very different things. A special needs trust is a first-party trust designed to hold money that is first-party assets such as inheritance, lawsuits, gifts, wages, or earnings.

If Megan were in a car accident and injured by a drunk driver, and we sued that drunk driver and won $50,000, we still want her to be eligible for Medicaid and SSI. This is when we would use a special needs trust. In Ohio, it can be created by the consumer, parent, grandparent, legal guardian, or the court. There are more rules for when and how that money can be used. But it will protect her eligibility for Medicaid and SSI.

One of the things I don't like about a special needs trust is that it has a Medicaid payback requirement. On Megan's passing, that money will not be used to pay for funeral and burial; that money will be used to pay back the State of Ohio for what the State of Ohio has paid on her behalf during her lifetime. Most times, you cannot repay anywhere near the total amount of the debt, so there is no recovery made over and above what the trust can pay, provided the person did not have any assets in their name. This is an important distinction. A third-party trust is a trust that will hold money that never legally belonged to the person with the developmental disability. The first-party special needs trust is designed specifically to hold money that belongs to the person with a developmental disability.

Here is another top-of-the-triangle reference for you. The Secure Act has been around for a couple of years now. If done correctly, a third-party discretionary trust can be an accumulation trust. That means the individual with the developmental disability can still receive a lifetime stretch or a lifetime payout of an inherited IRA.

Say you have three kids, a $300,000 home, $300,000 in savings, and a $300,000 IRA. Suppose the $300,000 IRA goes to the child with the developmental disability, and the other two kids split the other two assets. In that case, that child with a developmental disability is potentially going to be able to stretch the distributions from that retirement account. There are many moving parts with the Secure Act, so continue to pay attention and talk to professionals and keep your finger on the pulse in terms of that type of planning strategy, but in large part, stretching the distributions still does work.

Road mapping your estate plan

Road mapping is important. We spend much time with our clients road mapping. When you do an estate plan, a roadmap is critical. I'm not talking about who gets the toaster and the microwave, but who are your child's doctors? What are you advocating with the school about? What is going to make a transition to life without the parent easier? This is all part of a road-mapping process.

ABLE Act accounts are a first-party asset and are relatively new. They are a savings account for persons with developmental disabilities. They can save money in an ABLE Act account in a way that does not count towards their asset limit for the various government benefits we discussed. They are a great tool, but you must

understand how they work.

Different states have different ABLE Act account programs. The State of Ohio has the largest ABLE Act account program, STABLE. To use Ohio's program, you do not have to be an Ohio resident. It is not ideal for estate planning because it is a first-party account. When the individual dies, the money left in an ABLE Act account will be used to pay back their state of residence for expenditures the state has spent on their behalf. A few states have taken steps to make it so that ABLE Act accounts are not subject to Medicaid payback, and I tip my hat to those states. Good for you for doing that, but by and large, most states' ABLE Act accounts still require Medicaid payback at the time of death.

There are also strict limitations on how much money can be put into an ABLE Act account; only $16,000 a year can go into an ABLE Act account, so you have to be careful. That is another reason it does not work for inheritance if you want to leave a more meaningful sum of money.

What can ABLE Act accounts be used for? Any qualified disability expenses include basic living expenses, housing, and transportation. Many special needs trusts are first-party trusts with hard and fast rules that prohibit them from being used to pay for some of the things an ABLE Act account can pay for. A first-party special needs trust can make a distribution to an ABLE account. When dealing with the more restrictive rules of a first-party special needs trust, we run the distributions through an ABLE Act account to benefit from the wider variety of expenses it can be used to pay for.

The effects of bad planning

A big red flag is if the person is under guardianship or conservatorship. You must make sure you do the right type of planning to keep the money outside the scope of what your state court will have jurisdiction over when the mom or dad passes away. If the individual is on benefits, they are inheriting money, which creates a problem.

We do not want minors to inherit money in their name. We do not want people under guardianship inheriting money in their name. We do not want people on benefits like we have discussed today, inheriting money and then being kicked off these programs. Some common confusing situations, though specific to families with loved ones with developmental disabilities, are inheriting or buying a home. They can be done if structured correctly. Retirement accounts, too.

Bad trustees are always a problem. With this type of trust planning, it is critical to pick the right people to serve as trustee. If guardianship or conservatorship is in play, you might have to get the court involved in whatever it is you are doing if you do not do advanced planning. . You need somebody in your neck of the woods who provides these types of services for your clients.

Key Takeaways

- Traditional rules that pertain to when to apply for Social Security do not apply when there is a family member with a developmental disability. Because I have a child with a developmental disability, it doesn't mean I'll apply for Social Security at age 62. However, the impact on her will change the math for when and how I decide to apply. This is where the ball goes back into your court as a financial planner to help figure out how that math impacts the family.
- Understand the importance of government benefits and how easy it is to lose them with bad planning. You might become ineligible for a benefit in June, and the government may not catch wind of it until the following April. They will want to be paid back for every one of those months that you were ineligible for the benefits and receiving them.
- Special needs planning includes far more than just documents. I only briefly touched on it, but a roadmap and some of that process are just as, if not more important than, some of the trust planning we do. You have to have a map in place for what will happen when a loved one with a developmental disability's family is no longer there to be the support they have been for the person's entire life.

Helping Clients Provide for Their Child and Protect Their Retirement with Special Needs Planning – Trusts, Benefits and ABLE – Derek Graham

About [Derek Graham](), Partner, Resch, [Root, Philipps & Graham, LLC]()

Derek Graham is an attorney and partner at Resch, Root, Philipps & Graham, LLC in Dublin, Ohio. Derek's practice focuses on developmental disability law, special needs planning, guardianship and probate. Derek's practice in developmental disability law started in 2009 when his oldest daughter was born with Down syndrome.

Derek knows first-hand how confusing and complicated it can be when trying to navigate all of the medical, legal, social and benefit-related issues that families face. Derek enjoys helping to simplify the process and teach families about the legal topics that really matter to individuals with developmental disabilities.

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Posts .

How Social Security Benefits Taxation and IRMAA Raise Marginal Tax Rates in Retirement

Greg Geisler, PhD, CPA, Clinical Professor of tax accounting at Indiana University-Bloomington

Editor's note: This article is an adaptation of the live webinar delivered by Greg Geisler, in 2022. His comments have been edited for clarity and length.

You can read the summary article here as part of the January 2023 Retirement InSight and Trends Newsletter, worth 1.0 CE when read in its entirety (after passing the online quiz.)

By Greg Geisler, PhD, CPA, Clinical Professor of Accounting at Indiana University-Bloomington

The Social Security Tax Torpedo is a problem for moderate-income retirees. "Tax Torpedo" is just a cute word for a very high marginal tax rate. If you have additional income, that increases the amount of income subject to Social Security subject to income tax.

This article will address the Social Security Tax Torpedo and its very high marginal tax rates on very moderate-income retirees. Then we will discuss avoiding or reducing additional Medicare premiums if you are a higher-income retiree.

The Social Security Tax Torpedo

Who gets hit by Social Security Tax Torpedo's very high marginal tax rate? There are 10 million tax returns with some Social Security benefits but less than 85% included in income; in other words, they are subject to tax. These are the taxpayers inside the Tax Torpedo.

For example, if you are inside the Social Security Tax Torpedo and take a distribution from your 401(k), 403(b), 457, or IRA, whatever tax-deferred retirement account you want to talk about, they are 100% taxable. That causes more of your Social Security benefits to be taxed.

You can identify if you are inside the Social Security Benefits Tax Torpedo by looking at two numbers from your Form 1040 individual federal income tax return. If you are inside it, it could be as high as a 40.7% effective federal marginal tax rate or, if you have any long-term capital gain or qualified dividend income, as high as 49.95%.

This means that if you took another $100 out of your IRA or 401(k), you would pay $50 more federal income tax. Is there anything you can do about if you are in the 40.7% or 49.95% effective marginal federal tax rate bracket? Yes.

Two taxable events are happening. First, you thought you were just taking money out of your traditional retirement account, but it leads to more Social Security benefits being taxed. That is why the effective marginal federal rates are so high, such as 49.95% if you have any qualified dividend or net long-term capital gain income. If you do not have either of these, the rate can be 40.7%.

The most Social Security benefits that anyone can have subject to tax is 85%. If you receive $10,000 in Social Security benefits, then $8,500 would be the maximum subject to tax or included in your income.

The numbers on your tax return can tell you whether you are inside the Social Security Tax Torpedo range. Look at your total Social Security benefits for the year and the amounts included in the income of those Social Security benefits. So, let us say Social Security benefits were $10,000, and let us say that the taxable amount is $7,000. Well, $7,000 divided by $10,000 is 70%. You are in the Tax Torpedo range.

Now, what if your Social Security benefits were $10,000 and the amount included in your income was $8,500? Again, that is the maximum possible. You have now gone through the Social Security Benefits Tax Torpedo, which has hit you, but your taxable income now puts you above it.

Keep in mind that if someone is married filing jointly and both spouses are collecting Social Security, that would show up as one tax return for Social Security. There are over 60 million tax returns that report Social Security on them. Two-thirds have none of their Social Security benefits included in income or are taxable; they are below the Social Security Tax Torpedo. However, 10 million returns out of 60,000,000, or 1/6th, have some of their Social Security benefits taxable but below 85%; they are inside the Tax Torpedo. There are 10 million others with 85% of their Social Security benefits included in their income or taxable. They are above the top of the Social Security Tax Torpedo; they went through it. They had some of their income taxed at these significantly higher rates.

Where exactly is the worst part of the Social Security Tax Torpedo? It is different if you are single versus married filing jointly. If you are single for 2022, once your taxable income goes above $41,775, you jump from the 12% federal marginal tax rate to 22%. When do the 40.7% and 49.95% rates happen? They happen when the taxpayer's taxable income increases from 12% to the 22% federal marginal tax bracket. Once you jump into the 22% effective federal tax rate bracket, your additional income is taxed at either 40.7% or, if you have any qualified dividend or long-term capital gain income, 49.95%.

To demonstrate the effect of this 40.7% marginal rate, say someone was single, at the top of the 12% bracket, and they decide, "Oh, I need a little more spending money." So, they take out $1,000 more from their tax-deferred retirement account. You might think, "Well, he went from the 12% to the 22% bracket. So, on that $1,000 of additional income, they should pay another $220 in tax." They do not. They pay $407 more tax. Why? When they took $1,000 from their tax-deferred retirement account, another $850 of Social Security became income or taxable.

So, you now have $1,850 more in taxable income because you took $1,000 more out of your tax-deferred retirement account. The additional $407 in federal income tax is a marginal rate of 40.7%.

But remember, we all get deductions. If nothing else, we get the standard deduction. The standard deduction for a single person aged 65 or over is about $15,000 in both 2022 and 2023. That is why when total income gets above $57,000 if single and above $112,000 if you are married filing jointly, and if you are collecting Social Security, you will get into the worst part of the Tax Torpedo. For 2023, this total income will be closer to $120,000 for married couples, and there will be a $30,000 standard deduction.

What Can You Do to Avoid the Social Security Tax Torpedo?

So, what can you do? If you plan your taxable income such that you will get to the top of the 12% bracket (which again is a 22.2% effective federal marginal rate) and you are collecting Social Security, do not take any more money out of your tax-deferred retirement accounts, your IRAs, your 401(k)s. If you need more cash for the year, take it somewhere that does not trigger income. If you have any Roth IRA money, take it from there or draw from a taxable savings account.

Another suggestion: if you have yet to start Social Security, if you are in good health, if you have other sources for spending, then delay Social Security. You will get hit by the Social Security Tax Torpedo in fewer years. The fewer years you get hit by the Social Security Tax Torpedo, the better, purely from a tax efficiency standpoint and a lesser amount of the present value of federal income taxes you will pay over the years. Delaying Social Security is consistent with being more tax efficient. If the person lives a long life, there will be significantly fewer taxes than if they started Social Security earlier and were in the worst part of the Social Security Tax Torpedo most every year.

Other options are to

- Sell stocks where there is less appreciation
- Take a distribution from a Roth
- Take funds needed from an interest-bearing taxable account, or
- Take it out of a stock where you will have a capital loss or a little capital gain.

All these things can help you avoid the worst part of the Social Security Tax Torpedo.

The only way to do this is to figure out where you are as the year progresses. It is too late at the end of the year. Granted, once you turn age 73, you have required minimum distributions from all your IRAs and 401(k)s and other tax-deferred traditional retirement accounts. Social Security has started by the time you are 70, and many people, in this case, cannot avoid the worst part of the Social Security Tax Torpedo high effective marginal federal tax rates. In many cases, you could have done some things before you turned 70. Whether you started Social Security before age 70, keep your income to the top of the 12% bracket in taxable income.

How to Avoid Additional Medicare Premiums (IRMAA)

IRMAA stands for Income Related Monthly Adjustment Amounts. These are adjustments that increase how much Medicare premium you must pay. 2023's additional Medicare premiums are based on your 2021 adjusted gross income (AGI) plus your tax-exempt income. If anyone has to pay additional Medicare premiums in 2023, then two income amounts on their 2021 tax return exceeded the threshold.

Can you do anything to reduce or avoid the IRMAA tax? Yes, you can. But keep in mind, if you do something to keep your income at a level in 2023 where you do not go into a higher IRMAA tax threshold, that will help you in 2025 because 2025's additional Medicare premiums are based on 2023's income tax return.

If you retire and it is determined that you have to pay additional Medicare premiums for the next two years, file Form SSA-44. It is not a federal tax return but a form you file with the Social Security Administration, not the IRS, asking them to use income from a more recent year for determining your Medicare premiums. You will tell them, "Do not use income from when I was working full-time, and I had all that salary income. Use income from a more recent year when I am retired and for figuring out how much additional Medicare premiums I must pay."

On your 2021 tax return, if you are single and that amount is above $97,000, you will have to pay an extra $937 in Medicare premiums. What if you jump above $123,000 on your 2021 tax return in your income plus tax-exempt interest income? You are going to have to pay an additional $2,356 in 2023.

For those filing married joint, most of the amounts are double what they are for single. It is not taxable income; it is total income before any deductions. Most individuals' adjusted gross income, if they are retired, is the same as their total income. But remember to add tax-exempt interest. In other words, municipal bond

interest, state and local government bond interest, they make you add that in.

Suppose you are married and filing jointly, and your 2021 adjusted gross income plus any tax-exempt immunity bond interest income is not over $194,000. In that case, you pay the regular Medicare premiums. Once you get *one* dollar above $194,000 on your 2021 tax return for total income, you must pay $937 more in Medicare premiums.

What if both spouses are on Medicare? They would pay $937 for one spouse and $937 for the other, or almost $1,900 in additional Medicare premiums. Part B of Medicare is commonly called "medical." Part D is commonly called "prescription drug." Both of those premiums can increase if your total income gets above the threshold of $194,000.

I call additional Medicare premiums a tax. Why? Because it is based on two numbers off your tax return, adjusted gross income plus tax-exempt Muni interest. So, investing in Muni bonds does not solve your problem if you are high-income and must pay additional Medicare premiums.

Filing SSA-44 to Lower Medicare Premiums

You can only file the SSA-44 if there is a life-changing event. Once during a different presentation, I was asked 25 different ways, "My income was high this year, and then it will be lower next year. Can I file the SSA-44?" No. Not unless it is a life-changing event, which includes significant work reduction or work stoppage, which includes retirement. Let's say you sold a stock or a business and had a considerable income jump just for one year. That is not a life-changing event. You will be stuck with higher Medicare premiums two years later for that one year you had an abnormally high income.

You can file this SSA-44, explain that the work stoppage or the significant work reduction was your life-changing event, and use a more recent year's lower income instead of paying the higher amount of additional Medicare premiums. You might reduce it down to no additional Medicare premiums.

Let's say one spouse has already retired, and the higher-earner spouse retires at the end of 2022. Instead of having this couple reporting income for Medicare above $246,000 up to $306,000, they can report a more recent year's income as not above $194,000. The spouse with the life-changing event can help the other spouse qualify for lower premiums.

You need to file an SSA-44 for each spouse because additional Medicare premiums are per person on Medicare. In other words, one spouse's life-changing event, stopping work or significant reduction in work, can be the other spouse's life-changing event that qualifies them for lower Medicare premiums too. If the second spouse doesn't file an SSA-44, they could pay additional Medicare premiums of $2,356 per spouse or $4,700.

If your total income is one dollar above the income threshold for IRMAA, you will pay a lot more in Medicare premiums.

2023 Medicare Parts B & D Additional Premiums by AGI + TEI

Single tax return in 2021	Married filing jointly tax return in 2021	Monthly Additional Premiums	Annual Additional Premiums
$97,000 or less	$194,000 or less		
above $97,000 up to $123,000	above $194,000 up to $246,000	$78	$937
above $123,000 up to $153,000	above $246,000 up to $306,000	$196	$2,356
above $153,000 up to $183,000	above $306,000 up to $366,000	$314	$3,773
above $183,000 and less than $500,000	above $366,000 and less than $750,000	$433	$5,191
$500,000 or above	$750,000 and above	$472	$5,664

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In other words, if you are single and your income in 2021 is $97,001, you must pay $937 more in annual Medicare premiums. What about going over $123,000, even by only a penny? You will pay $2,356 more in Medicare premiums because you exceeded the $123,000 income threshold. See how harsh the additional Medicare premiums you must pay are when you jump to a higher step?

How to Manage Medicare Premiums After the First Two Years of Retirement

So, what can you do? You want an income plan to keep total income from jumping into a higher threshold. That way, you will save on paying too much additional Medicare premiums two years later. How do you do this income planning each year? You want to make tax-efficient decumulation, distributions, withdrawals, sales, spend-down, or whatever you want. You want to be tax-efficient in retirement, taking money out of your different accounts, such as taxable investments versus traditional retirement accounts versus Roth retirement accounts.

You want to be tax-efficient, with income going near the top but underneath the next threshold. How can you keep it from jumping to the next threshold if you need more income? Here is the conventional wisdom for tax-efficient decumulation/withdrawals.

1. First, decumulate (i.e., "draw-down" or "spend-down) all investments held outside retirement accounts (i.e., "nonqualified").

2. Then decumulate all tax-deferred retirement accounts (e.g., 401(k)s, 403(b)s, 457s, Thrift Savings, IRAs—i.e., "Traditional").

If you follow the above order, once the 2nd step is reached, $2,356 of IRMAA tax will be paid annually.

However, if subject to IRMAA, a taxpayer who gives to charity can reduce AGI and avoid paying $2,356 extra tax every year by making a Qualified Charitable Distributions (QCDs) (after age 70½) from IRAs:

- The distributions must go directly from IRA to the qualifying charity.

- These always reduce AGI.
- Non-QCD contributions to charity are itemized deductions that do not reduce AGI.
- For those who are at least aged 72, QCDs count toward an IRA owner's required minimum distribution (RMD) for the year.

Be aware that investing in a taxable account can disrupt your annual planning. If IRMAA is an issue for a taxpayer, that is a good reason not to have taxable money invested in actively managed mutual funds because

- They have uncertain capital gain distributions annually, and
- That can trigger IRMAA even if you do good annual planning.

Suppose you have any money in a Roth account; that is one way to receive additional funds that don't push your income into the next IRMAA threshold. Another way is to take funds from a qualified Health Savings Account that can be distributed if you have qualified medical expenses.

You can also take money from taxable accounts with a significant basis by selling some stock. Let's say you have $60,000 of stock with a $37,000 basis or a $23,000 gain. You have $60,000 in additional cash flow but will only include $23,000 in taxable income.

How Social Security Benefits Taxation and IRMAA Raise Marginal Tax Rates in Retirement – Greg Geisler

About Greg Geisler, PhD, CPA, Clinical Professor of Accounting at Indiana University-Bloomington

Greg received his PhD from University of North Carolina-Chapel Hill, is a Clinical Professor of tax accounting at Indiana University-Bloomington. He teaches a course called "Income Tax and Individual Financial Planning."

Greg publishes articles at the intersection of income tax and financial planning. Specifically, in the last ten years he has published 6 such articles in the Journal of Financial Service Professionals and 8 such articles in the Journal of Financial Planning (JFP), including two that received the 2017 and 2022 "Montgomery-Warschauer Award" for most outstanding article contributing to the betterment of the financial planning profession.

At his previous university, he was awarded the only 2017 Chancellor's Teaching Excellence Award.

He has been quoted in the Wall Street Journal and many times in the financial press and on newscasts.

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