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# ESTATE PLANNING IN THE CURRENT ENVIRONMENT



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## ESTATE PLANNING IN THE CURRENT ENVIRONMENT

### *Introduction*

- Flexibility and diligence in estate planning is critical
- 2024 Presidential election will have implications
- Current environment bodes well for estate planning
- Valuers are part of the estate planning team

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## ESTATE PLANNING IN THE CURRENT ENVIRONMENT

### *Introduction*

- **Topics covered today:**
  - Gift and estate tax exclusion amounts
  - Relevant guidance
  - Current valuation considerations
  - IRS enforcement

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## ESTATE PLANNING IN THE CURRENT ENVIRONMENT

### *Gift and Estate Tax Lifetime Exclusion*

- **Where have we been?**
- **Where are we now?**
- **Where might we be heading?**

Year	Exclusion	Maximum Tax Rate
2002	1,000,000	50%
2006	2,000,000	46%
2009	3,500,000	45%
2010	5,000,000	35%
2018	11,180,000	40%
2019	11,400,000	40%
2020	11,580,000	40%
2021	11,700,000	40%
2022	12,060,000	40%
2023	12,920,000	40%
2024	13,610,000	40%

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## ESTATE PLANNING IN THE CURRENT ENVIRONMENT

### *Gift and Estate Tax Lifetime Exclusion – Past, Present & Future*

- **With the exception of 2004 through 2010, federal gift tax lifetime exclusion amounts were the same as the estate tax exclusion amounts**
  - Federal gift tax exclusion amount was limited to \$1,000,000
- **Federal estate tax in 2010 was optional**

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## **ESTATE PLANNING IN THE CURRENT ENVIRONMENT**

### *Gift and Estate Tax Lifetime Exclusion – Past, Present & Future*

- **Anti-clawback rule was codified in 2019 – no tax is imposed on completed gifts that were tax free and made before 2026**
- **Absent new legislation, increased exemption amounts expire on January 1, 2026**
- **Exemption amount reduced to \$5 million, plus inflation adjustments**

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## **ESTATE PLANNING IN THE CURRENT ENVIRONMENT**

### *Gift and Estate Tax Lifetime Exclusion – Past, Present & Future*

- **Uncertainty as to whether any tax-related legislation will come out of Congress in 2024 and 2025**
- **This window of time is important for sizable estates**

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## **ESTATE PLANNING IN THE CURRENT ENVIRONMENT**

### *Relevant Guidance – 26 U.S. Code Subtitle B – Estate and Gift Taxes*

- **Chapter 11 – Estate Tax**
- **Chapter 12 – Gift Tax**
- **Chapter 13 – Generation-Skipping Transfers**

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## **ESTATE PLANNING IN THE CURRENT ENVIRONMENT**

### *Relevant Guidance – 26 U.S. Code Subtitle B – Estate and Gift Taxes*

- **Chapter 14 – Special Valuation Rules**
  - Section 2701 – Transfers of certain interests in corporations or partnerships
  - Section 2702 – Special valuation rules in case of transfers of interests in trusts
  - Section 2703 – Certain rights and restrictions disregarded
  - Section 2704 – Treatment of certain lapsing rights and restrictions

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### *Relevant Guidance*

- **Revenue Ruling 93-12 – Milestone ruling for family-owned businesses**
  - IRS abandoned family attribution
- **IRC Section 6695A – Appraiser penalty**
  - No penalty is imposed if the valuator establishes to the satisfaction of the Secretary that the value determined in the appraisal was more likely than not the proper value
- **IRC Section 6701 – Aiding and abetting understatement of tax liability**

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## ESTATE PLANNING IN THE CURRENT ENVIRONMENT

### *Current Valuation Considerations*

- **Fundamental Valuation Equation**

$$\text{Value} = \text{Economic Benefit of Ownership} \div \text{Required Rate of Return}$$

alternatively illustrated as

$$\text{Value} = \text{Earnings Stream} \times \text{Market Based Multiple}$$

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## ESTATE PLANNING IN THE CURRENT ENVIRONMENT

### *Current Valuation Considerations*

- **Numerator of the Value Equation: Economic Benefit of Ownership**
  - Future expected revenue generated by the business
  - Associated operating expenses required to generate the future revenue
  - Necessary investments in the form of capital expenditures and incremental working capital requirements

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## ESTATE PLANNING IN THE CURRENT ENVIRONMENT

### *Current Valuation Considerations*

- **Historic valuation inputs, specifically past performance, may not be a proxy for future performance**
- **There are several other considerations for valuation experts and business owners to weigh**
- **Leads to forecasting risk**

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## ESTATE PLANNING IN THE CURRENT ENVIRONMENT

### *Current Valuation Considerations*

#### ▪ Inflation

- Cost of materials
- Cost of labor (wages as well as the cost of recruiting and hiring)

#### ▪ Supply Chain

- Increased cost of goods (direct materials, freight, etc.)
- Delayed lead times (especially internationally)
- Slower revenue generation and recognition
- Scarcity of resources (equipment, inventory, materials)

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## ESTATE PLANNING IN THE CURRENT ENVIRONMENT

### *Current Valuation Considerations*

#### ▪ Required Rate of Return

- Buyer-specific risk analysis
- Inverse relationship to value
- Influenced by
  - Perceived risk inherent within investment opportunity
  - Rates of return on investment alternatives
  - Resultant risk/reward dynamics and pricing

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## ESTATE PLANNING IN THE CURRENT ENVIRONMENT

### *Current Valuation Considerations*

#### ▪ **Required Rate of Return**

- Changes in interest rates will impact the potential return on investment alternatives
  - As rates rise, investment alternatives become more attractive
  - The threshold for required return on an equity investment increases as rates of return for alternatives increases
- Lending environment
  - Financing acquisitions has become more costly
  - Shift in deal structure in recognition of impact on valuation

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## ESTATE PLANNING IN THE CURRENT ENVIRONMENT

### *Current Valuation Considerations*

#### ▪ **Impact on Valuations**

- Pressure on profitability, higher spend on capital investment, and need for additional working capital contribute to lower economic benefits
- Higher interest rates and elevated risk, both forecasting and specific-company, contribute to a higher required rate of return
- Lower economic benefits, combined with higher rates of return, result in lower equity values

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## ESTATE PLANNING IN THE CURRENT ENVIRONMENT

### *Current Valuation Considerations*

#### ▪ Adjustments to Value – Valuation Discounts

- Discounts associated with fractional interests in a privately held business must be warranted, properly quantified, and applied
- Risks or circumstances considered elsewhere in the valuation should not be double counted when determining the level of discounts
- IRS continues to challenge valuation discounts associated with gifts and estates
  - *Estate of Cecil v. Commissioner* (T.C. Memo 2023-24)

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### *Increased IRS Scrutiny of Gift and Estate Tax Returns*

#### ▪ Inflation Reduction Act

- Additional \$80 billion of funding over the next 10 years

#### ▪ Increased hiring levels

- The IRS offered positions to more than 560 accountants in November and December of 2023 to support additional enforcement
- Offering additional in-person and online resources to taxpayers
- Increased hiring nationwide, including six new engineers in the Pittsburgh region

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## ESTATE PLANNING IN THE CURRENT ENVIRONMENT

### *Increased IRS Scrutiny of Gift and Estate Tax Returns*

- **As a benefit of allocating resources towards enforcement, the IRS has collected \$482 million of tax debt from 1,600 millionaires as of January 2024**
  - IRS allocating nearly \$46 billion (69%) to improve and expand IRS enforcement
  - Increased enforcement surrounding large corporations, large partnerships and high-income individuals
    - Specifically includes gift and estate tax returns

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### *Final Thoughts*

- **IRS ramp up of personnel and enforcement results are real and impactful**
- **Engaging a qualified appraiser early in the planning process assists with avoiding potential tax issues and reduces exposure to IRS penalties**
- **Qualified valuers leverage gifts through application of sound valuation methods and proper quantification of valuation discounts**

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