LENOX ADVISORS, INC

WEALTH MANAGEMENT ADVISOR

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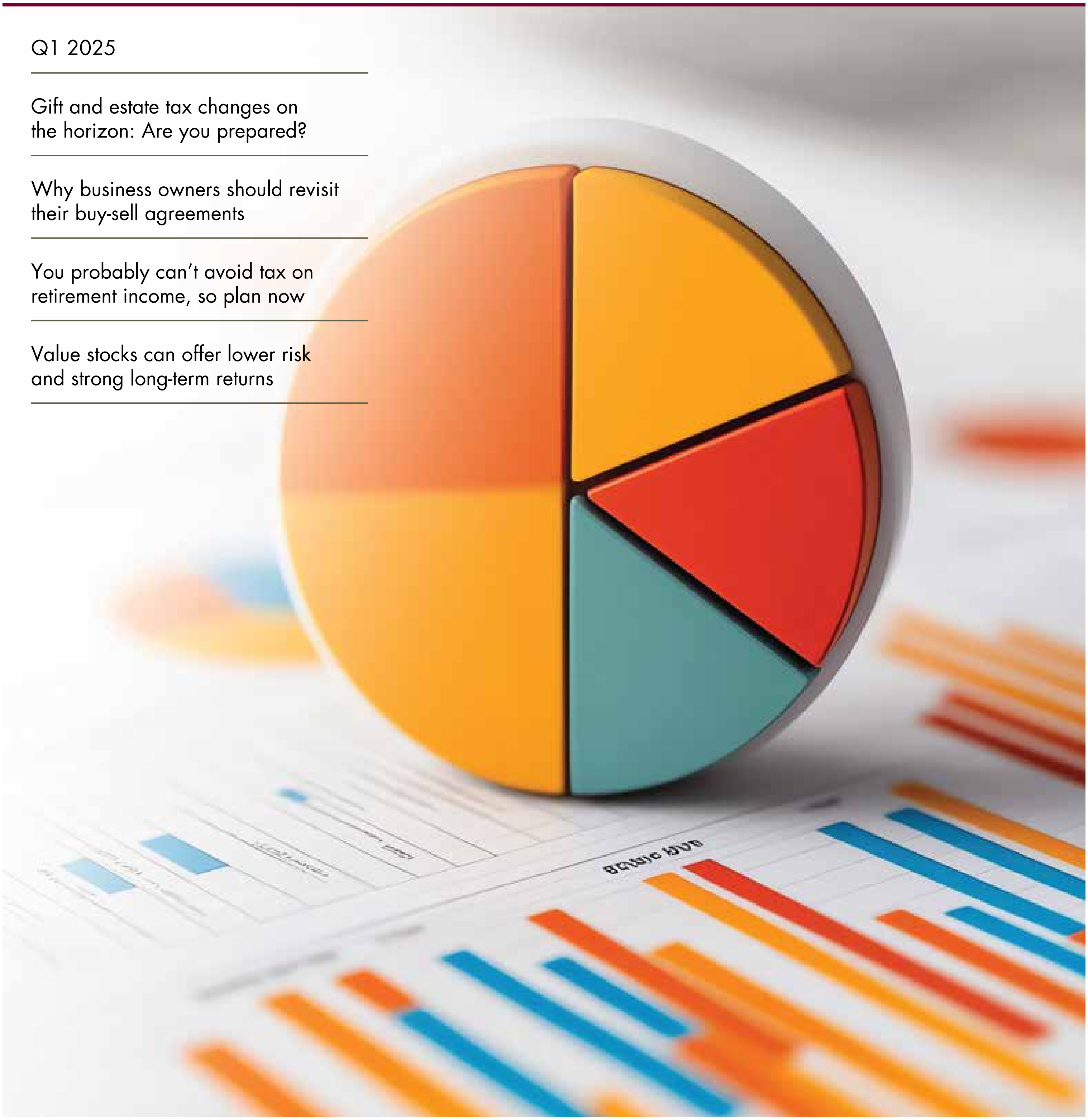

Gift and estate tax changes on the horizon: Are you prepared?

Currently, the gift and estate tax exemption for individuals is $13.99 million (a combined $27.98 million for married couples). But this lofty exemption amount, created by the Tax Cuts and Jobs Act (TCJA), wasn't designed to be permanent. The TCJA called for the provision to "sunset" at the end of 2025. Unless Congress extends it, on January 1, 2026, the exemption will be cut roughly in half to approximately $7 million for each individual (adjusted for inflation). In addition, the gift and estate tax rate above the exemption will increase from 40% to 45%.

If the law sunsets as scheduled, it'll have significant tax implications for many high-net-worth families. Fortunately, there are strategies you can use to lock in this year's exemption amount.

WHAT THE "SUNSET" COULD MEAN

What are the potential consequences of the gift and estate tax changes? Suppose, for example, that you have an estate worth $10 million at the end of 2025. Assuming the exemption drops to $7 million on January 1, 2026, your potential estate tax will have gone from zero to $1.35 million overnight [($10 million – $7 million) x 45%].

To prevent this from happening, you might use your current exemption to give away some of your wealth to loved ones, either outright or through an irrevocable trust. Once you make this gift, the assets are removed from your estate. Your recipients or beneficiaries enjoy all future appreciation in value free of gift or estate taxes.

Of course, you may not be ready to part with your assets just yet. In that case, there are tools you can use to take advantage of the current exemption amount while retaining some control over your wealth. Let's look at a few.

SPOUSAL LIFETIME ACCESS TRUSTS (SLATS)

For married couples, a SLAT makes it possible to remove wealth from your estate using the current exemption while effectively retaining access to it. A SLAT is an irrevocable trust you establish for the benefit of your spouse (or your spouse and your children or other

DON'T OVERLOOK INCOME TAXES

As you explore strategies for making the most of the current gift and estate tax exemption, be sure to consider potential income tax implications. Inherited assets generally are entitled to a "stepped-up basis." This means that the assets' tax basis is stepped up to their date-of-death fair market value, allowing your beneficiaries to sell appreciated assets without triggering a substantial capital gains tax liability.

Gifted assets, on the other hand, aren't entitled to a stepped-up basis. So, as you consider making substantial lifetime gifts, weigh potential gift and estate tax savings against potential income tax costs.

heirs). Typically, the trust permits the trustee to make distributions to your spouse if needed, which benefits you indirectly. As long as you don't act as trustee, and the trust is designed, funded and operated properly, the assets will be excluded from both your estate and your spouse's estate. But your spouse will have access to the trust funds should a need arise.

The downside of a SLAT is that your benefits depend on maintaining indirect access to the trust assets through your spouse. If you divorce or your spouse dies, those benefits will be lost. One way to mitigate the risk of death is for you and your spouse to each create a SLAT for the other's benefit. This allows each of you to use your exemption while retaining access to one of the trusts as beneficiary.

These arrangements must be designed carefully to avoid violating the "reciprocal trust doctrine." Under that doctrine, the IRS can undo mutual SLATs if their terms are substantially identical.

FLPS AND FLLCS

If you own a family business, you might want to structure it as a family limited partnership (FLP) or family limited liability company (FLLC). This would allow you to take advantage of the current exemption amount by giving away significant ownership interests to loved ones without immediately losing control of the company.

Suppose, for example, that you plan to leave the family business to your two children. In a typical arrangement, you would form an FLP to own the business and transfer a 49% limited partnership interest to each child, usually at a discounted value for gift tax purposes. You would retain a 2% managing partner interest, allowing you to maintain control over management decisions. Similar results can be achieved with an FLLC.

Structuring a business as an FLP or FLLC so that it doesn't come under IRS scrutiny can be challenging. That's why it's important to work with experienced advisors if you choose one of these options.

ACT NOW

There are other potential strategies you may be able to use to lock in the current exemption amount. Examples include qualified personal residence trusts (QPRTs), special power of appointment trusts (SPATs) and domestic asset protection trusts (DAPTs). But if you're interested in taking advantage of one of these strategies, you'll need to implement it soon. Once the clock strikes midnight on December 31, 2025, the opportunity may be gone.

Supreme Court's *Connelly* decision

Why business owners should revisit their buy-sell agreements

If you own an interest in a closely held business, a recent decision by the U.S. Supreme Court may cause you to rethink how you value and structure your buy-sell agreement. In *Connelly v. United States,* the court ruled that a company's obligation to redeem a deceased owner's stock didn't offset the value of corporate-owned life insurance (COLI) used to fund the buyout. As a consequence, some companies with redemption-type buy-sell agreements may want to consider restructuring them.

TALE OF TWO BROTHERS

The company in *Connelly* was a building supply corporation owned by two brothers. One brother owned 77.18% of the corporation's outstanding shares and the other owned the remaining 22.82%. To keep the company in the family, the brothers and the corporation entered into a buy-sell agreement. In the event that one of the brothers died, the agreement gave the surviving brother the option to purchase his shares. If the surviving brother chose not to exercise that option, then the company would be required to redeem the stock. To fund a potential redemption, the company purchased $3.5 million in COLI for each brother.

In 2013, the brother who owned 77.18% of the stock died, and the surviving brother declined to purchase his shares. Instead, he and the deceased brother's son agreed that the corporation would redeem the stock, pursuant to the buy-sell agreement, for $3 million. The deceased brother's estate filed an estate tax return reporting the value of his stock at $3 million. However, the IRS determined that the stock was worth $5.3 million and assessed additional estate taxes of nearly $900,000.

DUELING NUMBERS

The IRS and the estate agreed that the COLI proceeds were an asset that increased the company's fair market value. They also agreed that the company assets were worth $6.86 million, consisting of $3 million in COLI proceeds earmarked for the stock redemption and $3.86 million in "other assets and income-generating potential." (When the Court issued its decision, it was unclear on what happened to the $500,000 in insurance proceeds not used for the redemption.)

However, the parties disagreed about the impact of the company's obligation to redeem the deceased brother's stock. The estate argued that the obligation offset the COLI proceeds, so that the value of the stock was approximately $3 million (77.18% of $3.86 million). The IRS argued that the redemption obligation *didn't* reduce the company's value, so that the stock was worth approximately $5.3 million (77.18% of $6.86 million).

COURT'S DECISION

The Supreme Court needed to resolve a conflict among the federal appellate courts. To this end, it accepted the IRS's argument that "no real-world buyer or seller would have viewed the redemption obligation as an offsetting liability."

The Court offered an example: A corporation has one asset, $10 million in cash, and two shareholders, A and B, with 80 shares and 20 shares, respectively. The shares are worth $100,000 each. If the company redeems Shareholder B's shares for fair market value ($2 million), the company will be left with $8 million in cash and 80 outstanding shares, all owned by Shareholder A. Shareholder A still owns 80 shares worth $100,000 each and Shareholder B has $2 million in cash, so the redemption has no economic impact on either owner. Based on this reasoning, the value of the company in *Connelly* wasn't reduced by its redemption obligation and the deceased brother's stock was worth $5.3 million.

WEIGH YOUR OPTIONS

If your company's redemption-type buy-sell agreement exposes you to additional estate taxes, you may want to consider restructuring it as a cross-purchase agreement. In a cross-purchase agreement, surviving shareholders purchase a deceased shareholder's stock.

The Court acknowledged that such an arrangement would avoid the result in *Connelly*. But keep in mind that in a typical cross-purchase arrangement, each shareholder maintains insurance on the lives of the other shareholders, which can be costly and complicated with multiple or unequal owners. Discuss the pros and cons of this option with your advisors.

You probably can't avoid tax on retirement income, so plan now

When saving for retirement, how often have you thought about the effect of taxes on your future retirement income? Most people would probably answer, "not often." But the fact is, you'll likely owe tax on retirement income — how much depends on several factors. The sooner you start planning, the better.

3 TYPES OF ACCOUNTS

There generally are three types of retirement savings accounts. The first, taxable accounts, consist mainly of brokerage accounts. Taxes are due on investment gains in the year you sell them. If you hold these investments for less than one year, gains are taxed at your ordinary income tax rate. If you hold them for one year or longer, they're taxed at capital gains rates of 0%, 15% or 20%, depending on your adjusted gross income.

The second, tax-deferred accounts, include traditional IRAs and 401(k)

plans. You don't pay taxes until you withdraw funds in retirement, at which time withdrawals are taxed at ordinary income tax rates. Many people's tax rates are lower in retirement than during their working years.

Finally, tax-free accounts, including Roth IRAs and Roth 401(k)s, are funded with after-tax dollars. This means taxes have already been paid so funds are withdrawn tax-free during retirement. Tax-free accounts are usually the most beneficial retirement accounts from a tax standpoint.

If you have money in all three account types, you might withdraw funds from your taxable accounts first, tax-deferred accounts second and tax-free accounts last. This will give your tax-deferred funds longer to potentially appreciate. Or you could withdraw money proportionally from all accounts, thus stabilizing your tax bill over time.

MANDATORY WITHDRAWALS

When you turn 73 years old, you must start taking required minimum distributions (RMDs) from tax-deferred accounts and pay income tax on the withdrawals. Distributions currently must begin by April 1 of the year following the year you turn 73 and for subsequent years, they must be made by December 31. Failure to take RMDs may result in a penalty of 25% of the amount that should have been withdrawn (or 10% if a corrective distribution is made in a timely manner).

Each RMD is calculated based on the balance in a tax-deferred account on December 31 of the previous year. This is then divided by the applicable distribution period or a life expectancy factor based on your age. But RMDs can be minimized, and potentially avoided, by converting a traditional IRA or 401(k) to a Roth account. However, if you make a Roth conversion, you'll owe income tax on the full value of the account at that time.

SOCIAL SECURITY BENEFITS

You may also have to pay federal income tax on a percentage of your Social Security retirement benefits, though never more than 85%. To determine if your Social Security is taxable, add any nontaxable interest you earn to your taxable income and half of your Social Security benefit to arrive at your provisional income.

Talk to a financial advisor or visit the Social Security Administration's website to learn the tax bracket based on your provisional income. To have tax withheld from Social Security checks, you can specify a withholding percentage or you can make quarterly estimated tax payments to avoid a big tax bill and possible penalty when you file your return.

CURRENT OPPORTUNITIES

It may be possible to reduce tax on retirement income, even if you're already retired. And if you're still in the saving stage, consider contributing to different types of accounts so you'll have flexibility later on. Contact your financial professional for details.

Value stocks can offer lower risk and strong long-term returns

Growth stocks — equities that are expected to grow revenues faster than their average peers — have largely dominated markets over the past decade. But recent stock market volatility and fears of a recession have some investors turning from these generally riskier equities to value stocks. Should you? Here's what you need to know.

FUNDAMENTALLY SOUND, BUT UNDERVALUED

The goal of value investing is to identify companies whose stock prices don't currently reflect what the investor considers their value. These companies are fundamentally sound but are undervalued by the market. They may trade at a relatively low price for many reasons. But usually they're "cheap" because investors have reacted negatively to bad news, such as poor quarterly earnings or legal problems, or because the general market has declined and punished stocks across the board. Value investors hope that attitudes about these stocks will improve over time.

Investors use a variety of metrics to identify underperforming stocks. These include price-to-earnings, price-to-sales and price-to-book ratios. A low ratio relative to comparable stocks in the same industry may indicate that a stock is undervalued. It's important to understand, however, that a *low* price isn't necessarily a *bargain* price. Sometimes a company's stock price declines because investors have correctly discerned real problems. And even from a low starting point, it's certainly possible for stocks to fall in value further.

PRUDENCE AND PATIENCE REQUIRED

Value investors look for stocks they believe offer strong future growth and earnings potential that has been overlooked by the market. Successful investors typically research companies thoroughly to evaluate their management, niche, competitive environment, cash flow, growth and dividend history.

Patience and a long-term perspective are critical. There's a common misconception that buying bargain-priced stocks leads to immediate returns. In fact, it can take years before a value stock becomes what its investors consider fully valued. The performance of value stocks tends to be cyclical, alternately outperforming and underperforming other investments.

CHEAP STOCKS CAN GET CHEAPER

It's important to note that some value stocks never realize investors' expectations that their prices will rise. In fact, it's possible to lose money investing in any type of security, including "cheap" value stocks. To reduce risk, assemble a portfolio of different types of investments — for example, value and growth stocks, bonds of varying maturity dates, and both domestic and foreign securities. Your financial advisor can help you build a diversified portfolio based on your goals and risk tolerance.