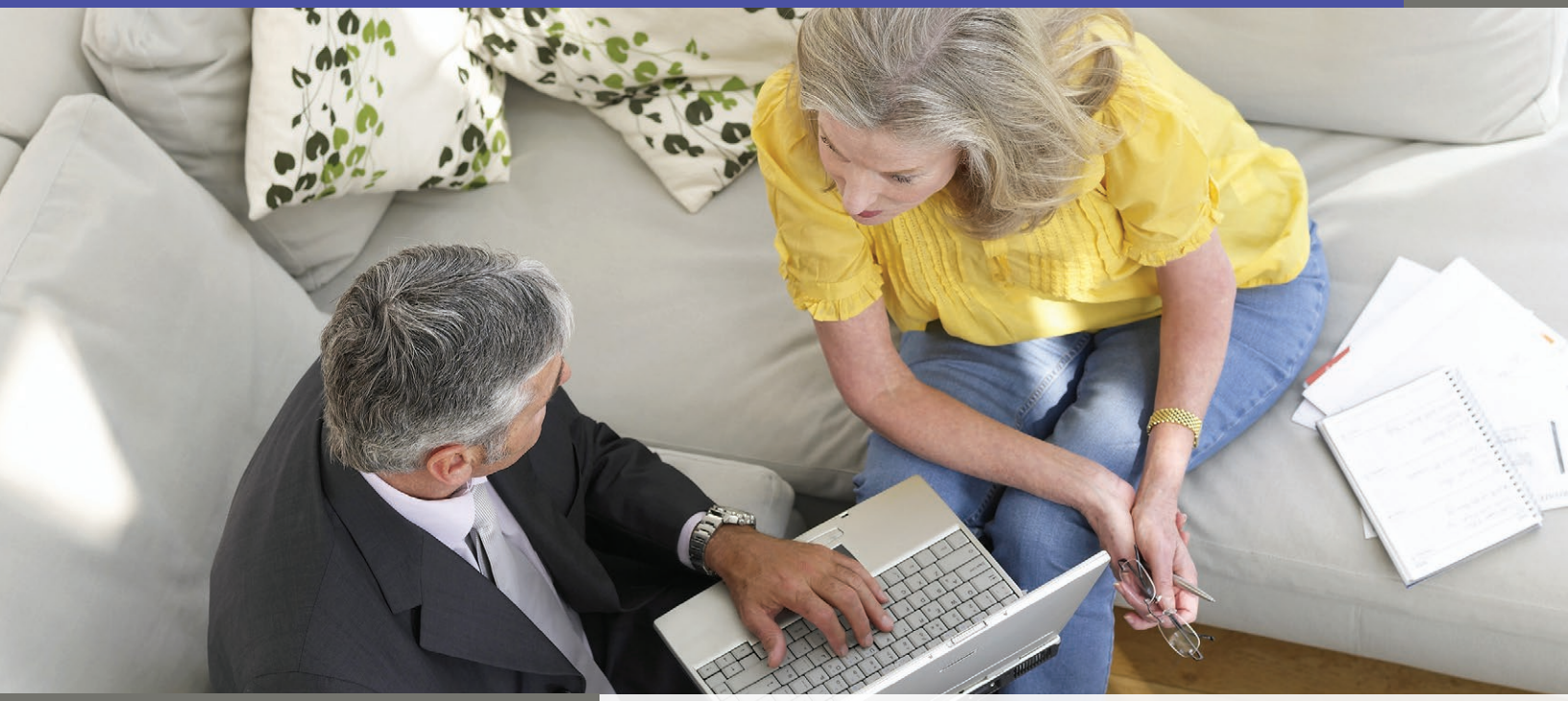

LAW FIRM MANAGEMENT

FALL 2023

Estate planning for attorneys
5 tax-efficient tools to transfer personal wealth

Paying attention to payroll

Is PTE tax attributable to a law firm?
Understanding pass-through entity taxes

Time to get serious about digital marketing

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5 tax-efficient tools to transfer personal wealth

The Tax Cuts and Jobs Act (TCJA) almost doubled the federal gift and estate tax exemptions. For example, in 2023, the annual gift tax exemption is $17,000 and the lifetime exemption is $12.92 million, or $25.85 for married couples. But the increased exemptions are scheduled to sunset after 2025. Here are some tax-efficient methods that your law firm's attorneys may want to consider for transferring their wealth.

1. GIFTS OF STOCK

Stock gifts can pay off for both the giver and the recipients. Gift givers avoid long-term capital gains taxes in the future and freeze the gift's value before shares appreciate further. If people wait to transfer such shares at death, the appreciation will become part of their estate. And, assuming the recipients are in a lower tax bracket, they'll take a smaller capital gains tax hit from a sale of the shares than the giver would.

Note: The IRS has made it clear that gifts made under the TCJA's higher exemption limits won't be clawed back into the estate if a giver dies after the higher limits expire.

2. GRATs

Grantor retained annuity trusts (GRATs) provide another option for transferring stock, as well as other appreciating assets, with few estate or gift tax consequences. The grantor funds a GRAT with a one-time contribution of assets. The trust will then pay the grantor an annuity for a specific term, and income, gains and losses flow to the grantor, not the trust. The total value of the annuity usually will equal the initial contribution. When the annuity payout term ends, remaining trust assets are transferred to the designated beneficiaries.

The grantor's gift tax amount is based on the present value of the beneficiaries' remainder interest in the initial contribution. That means appreciation both passes free of gift and estate tax and is removed from the grantor's estate.

3. IDGTs

Intentional defective grantor trusts (IDGTs) are another type of irrevocable trust that allows assets to grow free of gift or estate taxes. An IDGT is established with some "defect" that results in the IRS treating it as owned by the grantor for income tax purposes — for example, the ability to swap trust assets.

For people with liquid assets, intra-family loans can offer an effective method of wealth transfer.

The grantor can gift assets to an IDGT, and the initial value is applied against gift and estate tax exemptions. Grantors also can sell appreciating assets to their trusts without recognizing gains (because they're the grantors). Any sale should be for fair market value and in exchange for a promissory note that bears interest at the applicable federal rate. However, the interest rate can't be tied to income generated by the sold asset.

4. INTRA-FAMILY LOANS

For people with liquid assets, intra-family loans can offer an effective method of wealth transfer. The IRS permits family members to make loans

at rates lower than those available from commercial lenders.

The value of notes on such loans is locked in to the estate, but the funds can grow outside of it. And intra-family loans don't eat into gift or estate tax exemptions. These loans will, however, need to satisfy IRS requirements.

5. EDUCATIONAL GIFTS

Section 529 plans for paying qualified education expenses may be particularly appealing with the higher exemptions possibly ending soon. Gift givers can accelerate up to five years' worth of annual gift tax exclusions to make a large contribution to a 529 plan in a single year. For 2023, an accelerated contribution maxes out at $85,000 ($170,000 for a married couple).

A family education trust might prove an even better option. Taxpayers can contribute assets other than cash, invest in more kinds of assets (including 529 plans) and name multiple beneficiaries. In some states, a trust can hold assets indefinitely, helping future generations of beneficiaries and fostering greater growth than possible with a 529 plan. In addition, trust assets (other than 529 plans) can be used for noneducational purposes, such as paying medical bills.

THE RULES HAVE CHANGED FOR INHERITED IRAs

Until recently, beneficiaries of inherited IRAs could "stretch" required minimum distributions (RMDs) over their entire life expectancies. This made it possible, especially for younger beneficiaries, to take smaller distributions and defer taxes while their IRAs continued to grow.

The SECURE Act eliminated this option for many heirs, though. Under the law, if an IRA owner died in 2020 or later, the entire balance of the account must be distributed within 10 years of the death for most heirs (known as designated beneficiaries). In addition, under *proposed* IRS regulations, designated beneficiaries who inherit an IRA from a decedent who was already taking RMDs would have to take taxable annual RMDs in the first nine years, and then take the remaining balance in the tenth. They would not simply take a single lump-sum distribution in year 10.

If the proposed regulations become final, designated beneficiaries will lose tax planning flexibility. They also could be pushed into higher tax brackets in the years they're taking RMDs.

DON'T GO IT ALONE

There are many options for transferring wealth, but optimal strategies may shift as the end of the TCJA's generous exemptions approaches, unless Congress acts. Now is the time for attorneys to adjust their estate plans to maximize potential benefits. •

Paying attention to payroll

Your firm might have added people to the payroll in the past year. Or maybe it has increased the amount of work it outsources to independent contractors. Good for you! However, hiring support staff, associates and partners and paying independent contractors can make payroll management — already a challenge for some firms — more difficult. Here are some ways to keep your payroll efficient and in compliance.

MAINTAINING RECORDS

The U.S. Department of Labor (DOL) requires every employer covered by the Fair Labor Standards Act (FLSA) to keep records for each nonexempt worker. (State requirements may vary.) The law doesn't specify the form of records, but they must include certain identifying information about the employee and data about the hours worked and wages earned. Unsurprisingly, the law requires this information to be accurate.

Generally, firms should retain payroll records for at least three years, and wage computation records for two years. The latter include:

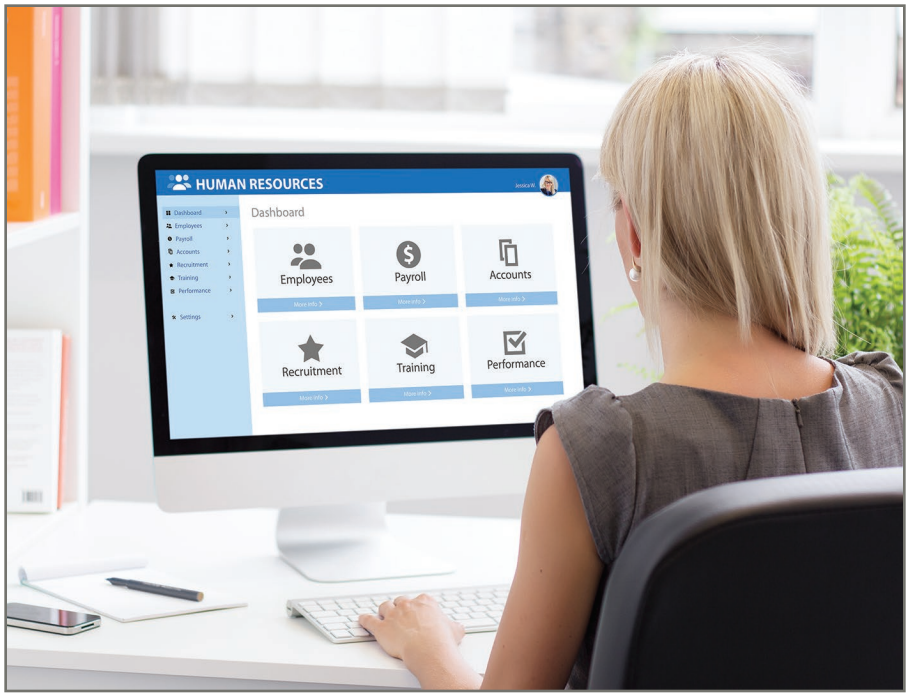
- Timecards,
- Wage rate tables,
- Work and time schedules, and
- Records of additions to or deductions from wages.

You may keep the records in your firm's office or at a central records office.

CLASSIFYING EMPLOYEES

Employee misclassification is always a hot topic. In 2018, the DOL updated guidance on the appropriate standard for determining whether employees are misclassified as independent contractors under the federal FLSA. And in 2019, it issued an opinion letter covering the classification of independent contractors in today's gig economy. In recent years, the DOL has entered agreements with many state agencies to cooperate in pursuing enforcement against employers that misclassify employees as contractors.

But contractor misclassification isn't the only type of misclassification on the DOL's enforcement radar. The FLSA exempts certain employees from overtime pay. Rules that went into effect in 2020 increase the earnings threshold required to exempt many executive, administrative and professional employees from the FLSA minimum wage and overtime requirements.



Your firm can claim an exemption from overtime regulations for employees who are "bona fide executive, administrative, professional and outside sales employees" if the employees meet certain conditions. But make sure you're familiar with state tests, which may be more stringent than federal ones.

Generally, law firms should retain payroll records for at least three years, and wage computation records for two years.

PAYING TAXES

Every employer must withhold Social Security, Medicare and income taxes from its employees' pay. Withheld Social Security and Medicare taxes, along with your firm's Social Security tax contribution, generally are known as payroll or Federal Insurance Contributions Act (FICA) taxes.

The Medicare tax rate for 2023 is 1.45% each for employees and employers, with no wage base limit. Your firm also must withhold an additional 0.9% Medicare tax from employees whose wages are in excess of $200,000 per calendar year. Only employees are subject to the additional Medicare tax, not employers. However, the Federal Unemployment Tax Act (FUTA) is your firm's responsibility. Employers must pay 6% of an employee's wages — up to the wage base limit of $7,000 — with a maximum credit of 5.4% for payments to state unemployment funds.

Failure to deposit any withheld taxes with the government on a timely basis can cause the IRS to hold your firm and other "responsible persons" personally liable for all outstanding amounts, plus penalties and accrued interest. You must report FICA wages and withheld FICA and income taxes quarterly (using Form 941) and FUTA wages and taxes annually (using Form 940). State withholding and reporting obligations vary.

KEEPING CURRENT

Reviewing the management of your payroll systems isn't a one-and-done deal. Laws affecting payroll taxes and other employee compensation issues can change. Contact your financial advisor annually to make sure you're keeping current with the latest requirements. •

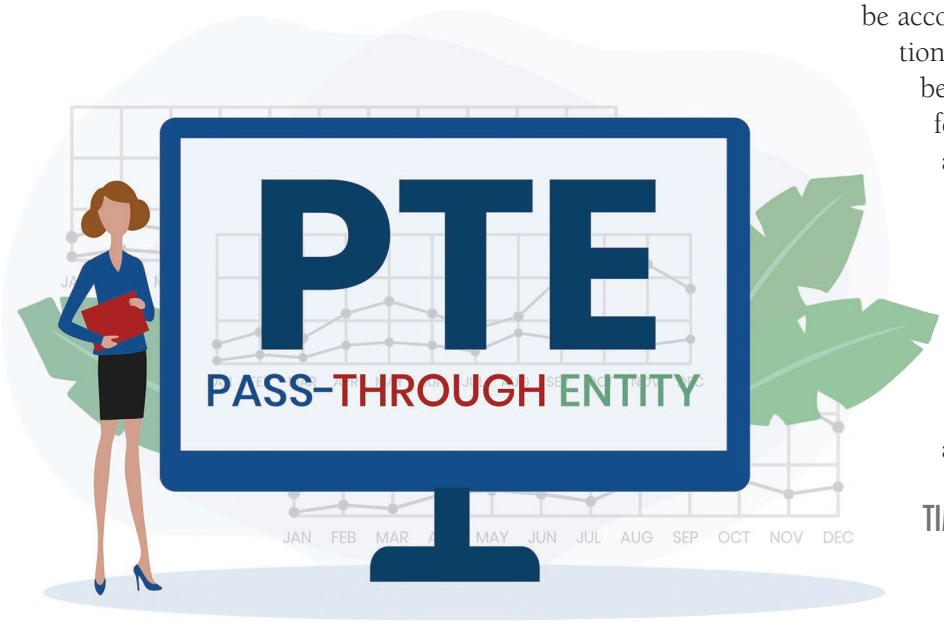
Is PTE tax attributable to a law firm?

UNDERSTANDING PASS-THROUGH ENTITY TAXES

Law firms that elect pass-through entity (PTE) taxation at the entity level, rather than at the individual partner or member level, can run into some accounting difficulties. Here's what you need to know about PTE taxation and how to avoid trouble.

DEDUCTION LIMIT WORKAROUND

After the Tax Cuts and Jobs Act of 2017 (TCJA) imposed a $10,000 limit on the federal income tax deduction for state and local taxes, most states responded with PTE taxes that provide



a workaround. The details vary by state, but these taxes generally allow covered PTEs to pay a mandatory or elective entity-level state tax on business income, which they can deduct in full as a business expense.

A PTE's partners or members then receive an offsetting owner-level tax benefit. The benefit usually is a full or partial credit, deduction or exclusion they can apply to their individual income taxes.

ACCOUNTING CONUNDRUMS

If your firm is subject to a PTE tax, you may need to account for the tax under Accounting Standards Codification (ASC) Topic 740, "Income Taxes" — but not necessarily. As noted, some significant variations exist among the different state PTE tax regimes, making it necessary for a PTE to determine whether its particular tax falls within ASC 740's scope.

ASC 740 will apply if the PTE tax is attributable to a law firm itself and based solely on taxable income (as opposed to other potential tax bases). If the tax were attributable to the partners or members, on the other hand, ASC 740 wouldn't apply. In that case, the PTE tax would be accounted for as an equity distribution, and a disparity could arise between the proper treatment for financial statement purposes and for tax return purposes. For financial statements, you would treat the tax as an equity transaction, not as an expense in the net income calculation. Yet, for tax purposes, your firm would take a deduction for it against federal taxable income.

TIMING IMPLICATIONS

Determining that a PTE tax is attributable to your firm has timing implications, too. For example, if your firm makes a PTE tax election before year end, it will account for the tax in the current period. If the election is made retroactively after year end, the tax won't be accounted for in the current period's financial statements and must be reported as a subsequent event.

On the other hand, if the PTE tax is considered an equity distribution, when you recognize it depends on when you commit to making the distribution. In other words, it depends on when your executive committee votes to take advantage of the PTE tax option. If the committee votes before year end, that's when the distributions accrue. It doesn't matter if the election wasn't actually made until after year end.

ANALYSIS REQUIRED

The determination of whether a PTE tax must be accounted for as a law firm's income tax liability or as an equity distribution will turn on the specific state law's various provisions (including whether it's elective or mandatory). The particulars will also play a role in any deferred tax effects and the timing and measurement of amounts in financial statements. Let us help you conduct the analysis necessary to properly report the payments on your financial statements. •

Time to get serious about digital marketing

For many law firms, digital marketing remains an afterthought. But simply having a stagnant website, largely dormant blog and no social media presence won't cut it, regardless of your firm's size or specialty. The competition for legal services is simply too fierce! If your firm is looking to develop or revamp its digital market strategy, consider some of these best practices:

Set goals. Clear goals are essential, but don't choose to pursue too many of them. Stick to goals that are achievable with some reasonable effort, such as:

- Increasing website traffic,
- Improving online ratings, or
- Generating more leads.

When setting goals, consider the amount of time and other resources you can afford to devote to the digital marketing.

Study your target audience. Your target audience depends on your practice areas. There's no point reaching people in need of a personal injury attorney, for example, if you do estate planning work. To connect with the right people, research their industries, interview clients and check out your competitors' digital marketing. Learn where your targets spend time and the types of messaging that resonates with them.

Select appropriate channels. Don't try to do it all — you'll reap a better return on investment if you focus on the channels that align with your target audience. That might mean online attorney directories, pay-per-click advertising, email marketing and/or social media. In fact, social media can go a long way to level the playing field with larger competitors. On which platforms are your targets more likely to be found online — LinkedIn, TikTok, Facebook or X (formerly known as Twitter)?

Don't neglect SEO. Search engine optimization (SEO) is essential to landing high rankings in potential clients' search engine results. Think about the keywords, including geographically specific ones, they use when searching for legal services and insert them across your website. Regularly updated content marketing is a valuable weapon when it comes to SEO. Articles, presentations and research on relevant issues provide an opportunity to work in keywords while simultaneously demonstrating your expertise.

Choose metrics. Finally, identify several metrics or key performance indicators to monitor the effectiveness of your strategy. Then review them at least quarterly. If numbers aren't where you'd like them to be, don't be afraid to tweak your metrics or make wholesale changes to your strategy. One of the many advantages of digital marketing is that it's relatively easy and cost-efficient to shift gears. •

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