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Assembly Required: A Guide to Buying, Holding, and Transferring "Toys"

Understand how the pieces of a comprehensive valuables plan fit together

Joshua Landsman
Senior Wealth Strategist

Matthew T. Lee
Senior Wealth Strategist

Key points

- It's important to understand the many variables to consider before you purchase a large toy such as a yacht, car, jet, or other collectibles
- Depending on what you purchase, you may have unique titling, tax, and insurance considerations
- When you've had your fun and are ready to pass on your toys, be sure to include specifications in your estate plan

Whether it's for a yacht, aircraft, car collection, or artwork, successful individuals often seek guidance when it comes to financing, owning, and transferring their "toys." This article is intended to be your "assembly guide" to highlight steps to consider when creating a plan for your toys, whatever they may be.

Step 1: Make Sure All the Pieces are There

Before you assemble your purchase plan, there are a few initial questions to consider:

What are you acquiring? While this may seem obvious, planning for the purchase of a yacht requires a different analysis than purchasing an aircraft or a collectible car, for example. Certain state and federal regulatory authorities may be involved, commercial insurance policies and loan underwriting may vary, and tax implications may differ depending on what you are acquiring.

What are your goals? While some may purchase a toy purely as a consumer, others may do so as a collector or as an investor. Which will you be? The answer could inform how your new purchase should be owned and what tax and estate planning strategies should be considered.

What is the toy's "value?" Value can be viewed in two ways. There is fair market value—the price a buyer is willing to pay—or sentimental value. Of the two, sentimental or emotional value can be more difficult to quantify but can be equally as important to the individual when considering a new purchase.

Step 2: Determine the Best Way to Pay for the Toy

As these items often require significant capital outlays, selecting the right structure for your purchase will be critical.

Although an all-cash purchase may avoid incurring debt, that may not be optimal. By using bank financing, you could preserve capital for other purposes, perhaps keeping funds invested in the market.

While bank financing may be advantageous, it is important to understand the current lending landscape, including the rate environment and how that may change over time. An idea of how long you intend to own the toy will also be important to align your financing with your ownership plan. This could inform the structure of your loan, whether fixed or floating rate, repayment schedule, and other financing terms.

In addition to financing costs, you should have a sense of anticipated maintenance expenses. As a general rule, you should budget for annual maintenance of around 10% of the purchase price. Budgeting appropriately for these expenses should avoid adding unnecessary pressure on your financial plan and allow for more years of enjoyment.

Step 3: Confirm How the Toy Should be Titled

There is no "one size fits all" when it comes to titling or ownership. Instead, the right form will depend on what is being acquired, how it will be used (i.e., business or personal), and what your estate planning goals and objectives are. Common options include:

Individual ownership. The most straightforward way to take title is in your name. However, for certain purchases, like an aircraft or yacht, an entity, such as a limited liability company (LLC) may be preferred, especially if you will use it partly for business purposes.

LLC ownership. An LLC could provide benefits that may not be available through individual ownership. This could include asset protection, as it adds legal separation between you and the asset. It could also provide structure to facilitate proper accounting and tax measures if the toy is used for business. The LLC could be owned by you or in a trust.

Trust ownership. A trust may provide similar benefits to an LLC depending on its terms and situs (location). States such as Delaware permit so-called self-settled asset protection trusts which could provide additional asset protection benefits. Direct ownership in trust can also streamline the administration of your estate, allowing for an orderly transfer of property at death.

Step 4: Determine the Proper Insurance for Liability Coverage and in Case the Toy Breaks

Selecting and maintaining proper insurance is critical to ensure coverage in the event of an unforeseen accident resulting in injury or damage. If you plan to finance your purchase, insurance may be required and proof of insurance provided before the closing takes place.

For example, yacht insurance is an insurance policy that provides indemnity liability coverage for sailing a vessel and is comprised of two parts: hull insurance and protection and indemnity (P&I). Hull insurance is an all-risk, direct damage coverage that includes an agreed amount of hull coverage.

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P&I insurance is the broadest of all liability coverages, and because maritime law is very specific, you will need coverages that are designed for those exposures. Longshore and harbor workers' coverage and Jones Act coverage (for the yacht's crew) are generally included and important because losses could be significant. P&I generally covers any judgements against you and can pay for legal defense in admiralty courts.

Insurance for aircrafts includes similar coverages as yachts, but you also might add secondary coverages to extend to loss of use, spare parts inventory, hangar keepers' liability, rental parts, and other potential sources of risk. Supplemental coverages can be added to cover hangar storage or international travel and might be considered as well. Care should be taken to have the policy written appropriately in cases where the aircraft is being used for both personal and business purposes.

In addition to these policies, you might consider adding an umbrella policy to extend coverage beyond the limits of existing primary insurance.

If you have valuable jewelry, collectibles, or artwork, you may consider obtaining an additional policy depending on the nature of the items or add coverage to an existing homeowners' policy.

Step 5: Understand What Federal and State Agencies May be Involved in the Purchase and Ownership of the Toy

If you are buying an aircraft, yacht, or collectible car, state, federal, and potentially international agencies may be involved in registering and documenting the purchase.

When purchasing an aircraft, for example, the Federal Aviation Association (FAA) will be involved throughout the process, including a precheck inspection and registration of the aircraft. For yachts, registration will be needed with the U.S. Coast Guard as well as the state agency that governs local registration of the vessel.

If title will be taken in an entity, like an LLC, the entity should be formed with the appropriate state division responsible for handling the formation of new business entities. Newly formed entities may also be subject to additional federal reporting requirements, like the Corporate Transparency Act, or state-level equivalents.

Step 6: Plan for Taxes That May be Due

While a complete review of all tax considerations is outside the scope of this article, the following are a few to keep in mind:

Sales and use taxes. At the time of purchase, you may pay a state or local sales tax, but you also should be mindful of use taxes in the future. Generally, use taxes apply when property is bought in one state with little or no sales tax only to be "used" in another. Careful planning can mitigate exposure to one or both of these taxes, if applicable, through the use of exemptions or credits.

Income tax deductions. If used as part of a trade or business, certain expenses could be tax deductible. For example, operational costs, storage, and maintenance of an aircraft may be deducible if it is used for business purposes. Under current law, bonus depreciation, a noncash expense, may allow you to accelerate some of the tax benefits into earlier years.

Capital gains taxes. While gains for most capital assets are taxed at 15 or 20%, your collectibles could be subject to a tax rate of 28%. For these purposes, collectibles would include antique cars, artwork, sports memorabilia, and other items classified as such under the federal tax laws. With the addition

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of the 3.8% Medicare surtax and any applicable state and local taxes, the income tax on the sales of your collectible could reach nearly 50% if you live in a high tax state. To mitigate these taxes, you might consider selling in a year in which you have prior tax losses; selling on an installment basis; or donating sale proceeds to charity.

Estate taxes. Any property you own at death is potentially subject to a federal and possibly state estate tax. At the federal level, the estate tax rate is currently 40% and applies to estates in excess of the lifetime exemption, which stands at $13.61 million per person. Exemptions and applicable tax rates vary among the dozen or so states that apply a separate state-level tax, but when combined with the federal tax, the total amount of taxes for residents of those states could be 50% or more. Having a plan to pay these taxes, often due within nine months of death, can be critical, especially if you have items that may take time to sell or that you wish to preserve for your family. Life insurance, coupled with an irrevocable life insurance trust, or ILIT, is one strategy that could be used to generate the necessary estate liquidity.

Step 7: Decide Who Gets to Play With the Toys

When it comes to your estate plan, there's a lot to consider. Some highlights include:

Lifetime gifting. If you may be subject to an estate tax in the future, you could use some or all of your lifetime exemption by gifting toys either outright to family members or to trusts for their benefit. To make the most of your exemption, you could place your toy in an entity, like an LLC, and give fractional interests of the LLC. By doing this, you may be able to take a valuation discount which, depending on the structuring of the entity and the assets it holds, could be as much as 30%.

Testamentary giving. Anything you own at the time of death will be transferred according to the terms of your estate plan, whether under your will or revocable trust. A common mistake is not specifically incorporating toys into an estate plan, in which case they could get distributed under customary general provisions governing the disposition of your "tangible personal property." For larger or valuable items, this may not be what you intend. A better approach would be to deal with anything of value separately, considering how and to whom they should be transferred.

In some cases, you may not wish to leave certain items to family, perhaps because they do not have the same interests or financial means. If it doesn't make sense to leave your toys to family, you could direct that they be sold with the proceeds distributed according to your wishes.

If you have collectibles, like artwork, that you would like to give to a museum or other charitable organization, you could direct this in your estate plan as well. This could provide a potentially valuable estate tax deduction. However, it is best to understand the needs and practices of the organization you intend to support so as to increase the likelihood the donation will be accepted.

Step 8: Enjoy the Toys

The goal of this article is to help you understand how the "pieces" fit together in the purchase of a new yacht, aircraft, car, or other valuable collectibles. While there is no one-size-fits-all approach, this assembly guide can hopefully serve as a helpful checklist as you think through the components of your next purchase, and sets a foundation for your enjoyment for years to come.

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Joshua Landsman
Senior Wealth Strategist
561.515.6996
jlandsman@wilmingtontrust.com

As part of the Wilmington Trust Emerald Family Office & Advisory® team, Josh is responsible for providing strategic and holistic wealth planning advice to successful high-net-worth individuals, entrepreneurs, executives, and their families by reviewing and illustrating their current plans, highlighting potential deficiencies, and modeling effective tax and estate planning strategies.

Josh holds a LL.M. in Taxation from New York University School of Law and a JD from University of Florida Levin College of Law, where he graduated cum laude with a Certificate in Estate Planning. Josh holds a bachelor's degree in marketing from the University of Florida.

Matthew T. Lee
Senior Wealth Strategist
212.415.0502
mlee2@wilmingtontrust.com

As part of the Wilmington Trust Emerald Family Office & Advisory® team, Matt is responsible for developing customized wealth management strategies and financial plans for high-net-worth individuals, families, and business owners in the Tri-State area that includes New York City, Westchester, Long Island, Connecticut, and northern New Jersey. Matt works closely with clients and their advisors to develop financial and tax planning strategies to help clients meet their current needs and plan for their long-term objectives.

Matt holds a JD from Northeastern University School of Law, where he was a member of the Law Journal, and is a graduate of Bowdoin College with a bachelor's degree in history. He is a member of the New York State and New York City Bar Associations and previously held a leadership role with the Boston Philanthropic Advisors Roundtable in Boston.