Legal Matters®

Estate Planning
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Estate planning still essential, despite increased exemptions

The Tax Cuts and Jobs Act (TCJA) reduces individual and corporate tax rates, eliminates a bevy of deductions and makes a host of changes to how Americans can preserve their wealth. Although the act falls short of repealing the death tax, it doubles the amount an individual may transfer tax free, either in his or her lifetime or at death.

Effective January 1, 2018 (and expiring December 31, 2025), the combined gift and estate tax exemption and the generation-skipping transfer (GST) tax exemption amounts double from an inflation-adjusted $5 million to $10 million.

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Taking into account inflationary adjustments, the actual amount for these exemptions is expected to be $11.2 million for an individual or $22.4 million for a married couple in 2018. Both exemptions will continue to increase with inflation. Both will also revert back to their current levels at the start of 2026. (Congress could also lower the exemptions before then.)

The increases present several opportunities for high-net worth individuals to consider:

- The higher exemptions may shield many families from estate taxes entirely, allowing them to simplify their planning strategies.
- Individuals who have already made gifts using the full lifetime exemption now have an opportunity to make additional gifts.

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Tax reform may impact charitable giving

As the tax reform measures were unveiled, members of the charitable community expressed alarm that the new rules could create a disincentive to donate.

With the larger standard income tax deduction ($12,000 for an individual filer and $24,000 for a married couple), fewer people will realize the benefits of itemizing.

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Some charities fear that, absent the tax write-off, fewer people will give. Yet others argue a household's higher net income will be a boon to non-profits.

How the tax reform changes will actually impact giving remains to be seen. Here's a summary of some ways the law might impact annual giving, as well as long-term planned gifts:

► **Higher AGI limits:** The new law retains the income tax charitable deduction, but the limits are higher. In any given year, you may deduct charitable contributions worth up to 60% of your adjusted gross income (up from 50 percent). However, AGI limits on certain gifts of appreciated property remain at 30 percent. You will still be able to carry forward contributions that exceed your AGI limits for up to five years.

► **Athletic seating:** The law repeals the 80 percent charitable deduction for gifts made in exchange for athletic event seating.

► **Itemizing threshold:** Some would-be donors may use charitable giving to boost them over the new itemizing threshold. That could be particularly relevant for donors with larger mortgages (and therefore higher mortgage interest deductions) or in high-tax states. The $10,000 cap on state and local mortgages, combined with $10,000 of mortgage interest, for example, could spur some households to make a $4,000 charitable gift to put them over the new standard deduction.

► **Unlimited estate tax deduction:** The unlimited estate tax deduction for charitable gifts remains. In a sense, that makes paying the federal estate tax voluntary, as you may elect to allocate anything above your estate exemption limits to charity. Higher exemption limits under the new law (roughly $11.2 million per individual or $22.4 million for a married couple) may encourage more families to give away the excess to causes they care about rather than letting funds go to government coffers.

► **New tax on certain college endowments:** The tax law imposes a new 1.4 percent excise tax on the investment income of private colleges with at least 500 students and assets valued at $500,000 or more per student. Endowment funds may be excluded if they are used to carry out a college's tax-exempt purpose, but the bill

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does not define which funds are subject to that exclusion. Some donors may reevaluate gifts until the interpretation becomes clear.

► **New excise tax on highly compensated nonprofit employees**. The tax reform bill now levies a 21 percent excise tax on nonprofit employers for salaries over $1 million. Analysis by the *Wall Street Journal* suggests that 2,700 nonprofit employees were paid more than $1 million in 2014, mainly at hospitals and universities (think presidents, football coaches and endowment managers). Again, this may cause donors to reconsider their gifts.

There are more tax-advantaged ways to give to charity beyond those listed above. Given the tax benefits, consider whether it would make sense to increase the amount you give or to make gifts sooner than anticipated.

Estate planning still essential, despite higher exemptions

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- Individuals may want to take advantage of the increased GST exemption to create GST-exempt trusts. Those with existing trusts subject to the GST tax may want to consider early distributions.
- It makes sense to review old life insurance trusts intended to pay an estate tax, and determine if the plan still makes sense or if it should be modified for other asset protection.
- If you don't want to adjust your gifts now, consider updating your durable powers of attorney to include a gift provision. If you became incapacitated, that would allow your agent to leverage the new exemptions.

Other elements of the changes

Here are some other important planning-related factors:

Dated formulas: Estate plans should be reviewed immediately if trusts are funded using a formula linked to the estate tax or GST exemptions. For someone who dies before 2026, these trusts may be funded more than intended, to the detriment of the surviving spouse.

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Conflicts with state law: There's a growing difference between the federal tax exemptions and similar exemptions afforded under the laws of 15 states and the District of Columbia. It's unknown how states will respond to the tax changes, so existing estate planning strategies may still be relevant.

Special situations: Don't get complacent and ignore estate planning because of the higher exemptions. Estate planning isn't just about taxes. You want a plan that's flexible enough to protect surviving spouses, minor children and special needs beneficiaries. Other planning nuances may include profligate beneficiaries, asset protection from beneficiaries' creditors or ex-spouses, family business succession, and more. Consult an estate planning attorney for guidance.

'Clawback' concerns linger under new tax law

The new tax reform package increases an individual's lifetime exemption from roughly $5.5 million to $11.2 million, with an expiration date of December 31, 2025.

For individuals who don't expect to die in the next eight years, your gift strategy could include protecting assets from future estate taxes while still maintaining adequate resources for your lifetime. You may, for example, choose to max out your lifetime exemption now, while you are still alive, to minimize the tax burden on your heirs when you die.

Let's assume you are a high-net worth individual with no surviving spouse. If you give your kids $11.2 million now, they receive those funds completely tax free. If you give them $5.5 million now, and they receive another $5.7 million when you die in 2026, your heirs would have to pay a 40% estate tax on that $5.7 million.

However, making a gift of the $11.2 million now does create a "clawback" concern if you die in 2026, when the gift tax exemption is lower. It's unclear if the IRS will apply the gift tax exemption amount applicable at the time of the gift or at the time of your death.

Congress attempted to address this issue, but analysts disagree over how the relevant language should be interpreted. Some advisors feel confident that the new law directs the Treasury to issue regulations clarifying that gifts made prior to 2026 will not be clawed back and rendered taxable. Others suggest that the language is ambiguous enough to leave room for interpretation.

What's more, high-net worth individuals should be aware that the new lifetime exemption limit could change if political power shifts. If President Donald Trump loses the 2020 election and the Democrats gain control of Congress, the law could be changed and limits lowered before the 2025 expiration date.

It's important to discuss the implications of this uncertainty for your estate plan with your estate planning lawyer.

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Evaluating generation-skipping tax transfers

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Your current financial plan may include wealth transfers to grandchildren, great-grandchildren or other descendants, and these gifts may be subject to a generation-skipping tax (GST). The GST was created to prevent families from essentially "skipping" a generation's worth of estate taxes as wealth is passed down.

In 2017, the GST exemption (the amount that can be transferred to grandchildren without incurring a federal GST tax) was $5.45 million adjusted for inflation. Now, under the new tax reform law, the GST exemption is doubled to roughly $11.2 million. In 2026, however, the exemptions revert back to pre-2018 levels.

Doubling the exemption presents an opportunity for families to increase wealth transfer plans without incurring taxes. Individuals may want to take advantage of the increased GST exemption to create GST-exempt trusts. Meanwhile, those with existing trusts subject to the GST tax may want to consider early distributions to take advantage of the higher exemption.

Check for unintended consequences

The higher exemption may create complications for individuals with plans funded according to the exemption limits effective on the date of their death. Those plans should be reviewed quickly, as the changes could have a significant, and unintended, impact.

Assume, for example, your plan is written to max out your GST exemption. Under the old law, your grandchildren would have gotten about $5.6 million. Under the new law, they'd get roughly $11.2 million — possibly leaving your surviving spouse without sufficient resources.

Other considerations:

- If your children have a sizable estate, it might make sense to put some or all of your estate into a GST trust to be given to the grandchildren. That avoids increasing your children's taxable estate.
- Some wills and trusts contain a clause that states that amounts exceeding the available GST exemptions are to be allocated to charity. Given the changes in the law, you may need to reevaluate your giving plans accordingly.