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Year-end Estate and Tax Planning

by Leena Ketkar

As 2016 comes to a close, now is the time to think about your estate and tax plan. The following discussion provides an overview of current law and tips to help you maximize tax savings.

1. Exclusion/exemption amounts

- For federal estate and gift tax purposes, the applicable exclusion amount, at $5.45 million for 2016, will rise to $5.49 million in 2017, allowing married couples to transfer just under $11 million tax-free. Any amounts transferred in excess of the exclusion amount will be subject to a 40 percent tax rate. In addition, for 2016, every individual can make an outright gift of $14,000 to an unlimited number of individuals (and married couples can double that amount) without incurring any gift tax consequences or dipping into the lifetime applicable exclusion amount discussed above. The federal generation-skipping transfer tax exemption amount, at $5.45 million for 2016, will rise to $5.49 million in 2017.

- On the state death tax front, New Jersey is phasing out its estate tax, with the exemption increasing from $675,000 in 2016 to $2 million in 2017 and ultimately being repealed effective Jan. 1, 2018.

2. Contribute to 529 Plans

- A 529 qualified tuition plan (or 529 Plan) is designed to encourage saving for future college costs. There are two different types of 529 Plans: prepaid tuition plans and college savings plans. The prepaid tuition plan allows beneficiaries to purchase credits at participating colleges and universities for future tuition; most plans are sponsored by state governments and have residency requirements. College savings plans allow for the creation of an account for the student for the purpose of paying the student’s eligible college expenses. A college savings plan account holder is able to choose from many investment options, including stock, mutual funds, money market funds and age-based portfolios.

- A 529 Plan allows income accumulated to not be subject to federal income tax, provided that the funds are used for qualified educational expenses. For a 529 Plan, there are no income, state residency or age restrictions. Special rules allow a donor to contribute up to $70,000 to a 529 Plan without a reduction in the applicable gift tax exclusion in a single year (married couples can contribute up to $140,000). Furthermore, many states give full or partial state income tax deductions for contributions to a 529 Plan; Pennsylvania provides for a deduction of $14,000 per year.

3. Valuation discounts

- The IRS issued proposed regulations that appear to substantially reduce (or even eliminate) the use of valuation discounts for minority or restricted interests in family-controlled entities. The hearing was scheduled for Dec. 1. At the hearing, valuation experts, business advisors and taxpayer advocacy groups commented on potential problems and issues that would result if the Section 2704 proposed regulations were finalized. At this time, it is not clear when these regulations might be finalized.

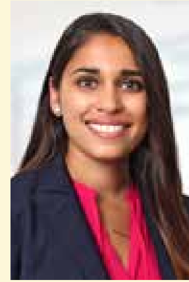
  If you have an interest in a family-controlled entity, you should review your planning with your advisers as soon as possible. It may be appropriate to transfer your affected business interests at the discounted value before this discount is severely reduced or eliminated. [For more information on valuation discounts and the proposed regulations, see this article http://www.stradley.com/insights/publications/2016/09/estates-advisory-september-2016.]

4. Applicable Federal Rate

- The Applicable Federal Rate (AFR) remains low, and is significantly lower than the commercial lending rate. The low AFR makes complex estate planning techniques, such as Grantor Retained Annuity Trusts (GRATs) or Intentionally Defective Grantor Trusts (IDGTs) particularly appealing.

  A. **Grantor-retained annuity trusts**
  A GRAT is an effective estate planning tool when interest rates and asset values are low. To create a GRAT, a grantor makes a gift to the GRAT in exchange for an annuity for a specific number of years. The value of the grantor's gift is equal to the value of the remainder interest in the GRAT when the GRAT is funded. One version of the GRAT strategy is to make the gift of the remainder interest as small as possible so that the grantor uses the least amount of his or her applicable exclusion amount. After the term of the GRAT expires, leveraging of the applicable exclusion amount is realized once the appreciation of assets in the GRAT (beating the AFR) passes to the beneficiaries, free of any additional federal estate or gift tax. For a GRAT to be effective, the grantor must survive the term of the GRAT, or else the GRAT's assets are included in the grantor's estate for federal estate tax purposes.

  B. **Intentionally defective grantor trusts**
  An IDGT is another effective estate planning technique when interest rates are low. To use this technique, the grantor first creates a "grantor trust," structured so that the assets in the trust would not be included in the grantor's estate for estate tax purposes but the grantor is treated as the owner of the trust assets for income tax purposes. The grantor then sells assets to the trust. Often a sale to an IDGT is used to "freeze" (for estate tax purposes) the value of the assets being sold to the trust by exchanging them for a promissory note with a stated interest rate and principal amount. Any appreciation of the assets after the sale to the trust is not included in the grantor's estate; further, if the asset is a family-controlled entity, valuation discounts may also apply. Under this strategy, there is no capital gain on a sale and the annual interest payments on the promissory note would not be taxable, because an IDGT is a grantor trust for income tax purposes.



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5. Charitable contributions of an IRA

- Taxpayers 70.5 years and older who are required to take minimum distributions from their IRAs and are charitably minded can donate up to $100,000 of their IRA distributions directly to a charity. While the charitable contribution is not deductible for the taxpayer, it is excluded from the taxpayer's gross income, which has the same effect.

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While President-elect Donald Trump will not be sworn into office until Jan. 20, 2017, he has, on numerous occasions and platforms, communicated his commitment to repeal the federal

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estate tax. While no specific proposals have been put forth, it is likely that the estate tax will be modified, or possibly repealed, in the upcoming year and that many other changes will be made to the current estate and tax laws.

The uncertainty of the future of the estate tax is something to monitor closely in early 2017.

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While there is uncertainty surrounding the estate tax, and changes to the tax code by President-elect Trump are possible, the above-mentioned strategies are just some of the tools available to help you maximize your tax savings as the end of the year approaches. We look forward to hearing from you to discuss your estate planning goals and objectives, and to help determine which strategies might be appropriate for you, your family and/or your business. ■

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