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Estate Planning Year-End 2018

by *Amanda M. Kita*

As 2018 winds down, it is a good time to consider the implications of the Tax Cuts and Jobs Act signed into law in December 2017, and think about tax planning for the future.

1. Current laws

While the Tax Cuts and Jobs Act did not repeal the estate tax as was originally proposed, it did double the Applicable Exclusion Amount for federal gift and estate tax purposes from \$5 million to \$10 million. The inflation-adjusted amount for the remainder of 2018 is \$11.18 million for individuals and \$22.36 million for married couples. Transfers in excess of the Applicable Exclusion Amount are subject to a 40 percent tax rate.

The Applicable Exclusion Amount will continue to be adjusted annually for inflation (in 2019, the Applicable Exclusion Amount will rise to \$11.4 million for individuals and \$22.8 million for married couples). The generation-skipping transfer tax exemption amount continues to mirror the Estate and Gift Tax Exclusion Amount, at \$11.18 million for 2018 and \$11.4 million for 2019. The annual exclusion for gift tax is \$15,000 for 2018 – a \$1,000 increase from 2017. This exclusion amount is anticipated to remain the same for 2019.

Note that the Applicable Exclusion Amount increase for federal gift and estate tax purposes is set to expire after 2025. Without further legislation, in 2026, the Applicable Exclusion Amount will return to an inflation-adjusted \$5 million. The IRS has issued proposed regulations and a news release concerning various effects of the increase in gift and estate tax exclusion amounts that are in effect from 2018 through 2025 and the post-2025 decrease in those amounts back to pre-2018 levels. Notably, the proposed regulations would provide that taxpayers who take advantage of the increased exclusion amounts now will not be adversely affected by the post-2025 decrease. This creates a great estate planning opportunity for those individuals who are in a position to take full advantage of the \$11.8 million Applicable Exclusion Amount by making a large gift, whether outright or through various strategies that allow for significant leveraging of the Applicable Exclusion Amount using valuation discounts and certain trust vehicles (see below), among other techniques.

2. Make gifts!

For 2018, every individual can make an outright gift of up to \$15,000 to an unlimited number of individuals, without incurring any gift tax consequences or dipping into the lifetime applicable exclusion amount. Married couples can jointly give up to \$30,000 to an unlimited number of individuals. The time to make those annual exclusion gifts is now!

3. IRA direct rollover to charity?

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 distribution 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.

4. 529 Plan Contributions

The Tax Cuts and Jobs Act also expanded the use of 529 education savings accounts. 529 plans were originally created in the 1990s in two different versions: a prepaid tuition program and an investment savings plan. Under the old federal tax rules, 529 plans could only be used for eligible colleges and universities. With the Tax Cuts and Jobs Act of 2017, federal rules were expanded to also allow 529 plans to cover qualifying expenses for private, public and religious school, kindergarten through 12th grade.

When money is distributed from the account to pay for qualified educational expenses, the distribution of the principal and earnings is tax free. If a distribution isn't used to pay for qualified education expenses, the earnings are taxable and there is a 10 percent federal tax penalty.

Contributions to a 529 account also qualify for the annual gift tax exclusion. Individuals can deposit up to \$15,000 per account beneficiary in 2018 without worrying about the effect on their lifetime estate and gift tax exclusion. In addition, a person can bundle up to five years of annual gifts in one year, allowing them to make up to \$75,000 of tax-free contributions per beneficiary in one year.

5. Grantor-Retained Annuity Trusts / Qualified Personal Residence Trusts

A GRAT is an effective estate planning tool, especially when interest rates are low and asset values are low or undervalued. To create a GRAT, a grantor makes a gift to the GRAT in exchange for an annuity for a specific term 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. The value of the remainder interest should be as small as possible, so that the grantor uses the least amount of his or her applicable exclusion amount. After the term of years for the GRAT expires, leveraging of the applicable exclusion amount is realized once the appreciation of assets in the GRAT 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; otherwise, the GRAT assets are included in the grantor's estate for federal estate tax purposes.

Similar to a GRAT is a QPRT, which may be an attractive option for individuals owning a high-value personal residence or vacation home. A QPRT involves the individual/grantor transferring his or her personal residence or vacation home to the QPRT and retaining the right to live in the home for a fixed term of years. Upon the expiration of the term of years, the home passes outright to the remainder beneficiaries or is held in

further trust for their benefit. The grantor may turn around and lease the property back from the remainder beneficiaries or the trust (as the case may be). QPRTs may be used in conjunction with other estate planning techniques, but are particularly appealing for individuals who might not have other high-value assets they are willing or able to gift at the time.

6. Dynasty trusts

A Dynasty Trust can be a powerful estate planning tool if you have a large estate, you want to control the use of the assets for a long time and you want to minimize taxes.

One of the biggest advantages of a Dynasty Trust is that it can provide significant savings in estate taxes. The creator of the trust may allocate some or all of his or her Generation Skipping Transfer tax ("GST Tax") exemption to the assets gifted to the trust.

The assets that are gifted to the trust are subject to federal gift tax, but any growth thereafter is forever sheltered from GST Tax. Income taxes are still due on income that the trust generates. For this reason, Dynasty Trusts can be funded with non-income-producing assets, such as growth stocks that do not pay dividends, or tax-free municipal bonds. It is also common to purchase life insurance policies in Dynasty Trusts, thereby removing the death benefit from the insured's estate, as well as closely-held business interests.

When creating the trust, the Settlor has a lot of flexibility over the future administration of the Dynasty Trust. The Settlor can decide who the beneficiaries are and what rights they have – usually, children are the first level of beneficiaries, and after their deaths grandchildren, and so on.

The trustee or trustees appointed control the assets and follow the terms of the trust.

Dynasty Trusts are irrevocable, and descendants generally cannot alter the terms of the trust. Therefore, the Settlor is making these financial decisions for their descendants decades in the future.

7. SLATs

A Spousal Lifetime Access Trust ("SLAT") allows couples (or even one spouse) to use their full remaining gift tax exemption while retaining access to the gifted property in the event they need it. Each spouse creates an irrevocable trust and contributes property with a fair market value up to his or her remaining gift tax exemption. Each spouse is the beneficiary of the trust created by the other spouse, and their descendants may be additional beneficiaries.

The trust property is not subject to federal estate tax upon the death of either spouse. Each spouse may also allocate his or

her generation-skipping transfer tax exemption to the trust each creates, which will shelter the trust assets from transfer taxes at each generation for as long as the trust is permitted to exist under state law.

There are a few limitations. During a spouse's lifetime, there must be a prohibition on distributions that would satisfy his or her obligation to support the other spouse. Also, there need to be adequate differences between the trust provisions of the two SLATs so that they are not deemed reciprocal trusts, which could result in the SLATs' assets being included in the spouses' estates for estate tax purposes.

8. Maximize retirement plan contributions

Individuals should also be aware of the amounts contributed to employer-sponsored retirement plans and to individual retirement accounts. Contributing the maximum allowed is likely a smart move.

For 2018, the maximum that may be contributed to a 401(k), 403(b), 457 or SARSEP is \$18,500. Taxpayers who turn 50 during the current tax year, or who are over age 50, may make an additional catch-up contribution of up to \$6,000. In addition, employers may contribute to an employee's plan depending on how much the employee contributes.

The contribution limits for traditional IRAs and Roth IRAs are \$5,500 for each. Similar to the retirement plans noted above, taxpayers who meet the 50 and older age limit may contribute an extra \$1,000. Roth IRAs, however, have income restrictions: The amount that may be contributed decreases for taxpayers with modified adjusted gross incomes of over \$120,000 for single tax filers, and over \$189,000 if married and filing jointly (phasing out completely for individuals with modified adjusted gross incomes of over \$135,000 for single tax filers, and over \$199,000 if married and filing jointly).

You may also consider whether you want to convert your traditional IRA to a Roth IRA. Converting allows the tax-deferred growth that a traditional IRA provides to become tax-free growth. Another advantage to Roth IRAs is that there are no required minimum distributions once the account holder reaches age 70 ½. You may leave that account untouched as an asset that grows tax-free, and leave it to your beneficiary through the account's beneficiary designation.

While there is an income limit when establishing a Roth IRA, there is no income limit for a holder of a traditional IRA to convert to a Roth. However, the converted amount is taxable during the year of conversion.

9. FSA

A Flexible Spending Account (FSA) may be a great way to save for medical and dependent expenses and save on taxes at the same time. Many employers offer FSAs, which allow you to contribute money on a pretax basis, so it lowers the amount of income on which you are taxed. The funds contributed to an FSA may be used for certain expenses related to health care or dependent care. Employers set the account limits, but the IRS allows a maximum of \$2,650 for an FSA for 2018, which is set to rise to \$2,700 for 2019. The IRS allows a maximum of \$5,000 for a dependent care FSA (for married couples filing jointly).

One disadvantage is that FSAs are "use it or lose it," in that individuals with an FSA must use their funds saved in their accounts in a certain period of time. However, there is usually good outreach to employees approaching year-end to let them know of their unused FSA balances. There is also some flexibility on the deadline. Employers may offer a two-and-a-half-month extension for employees to incur and submit claims. There is also a "carryover rule" that lets individuals carry over up to \$500 of their unused FSA balance into the next year. Companies can choose whether or not to take advantage of these options, and employees should make themselves aware of what FSA plan options their employer provides.

Conclusion

The above-mentioned strategies are just some of the tools available to help you maximize your tax savings as the end of the year quickly approaches. We look forward to hearing from you if you have any questions about your estate planning goals and objectives, and determine which strategies might be appropriate for you, your family and/or your business.



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