

How Does the New Tax Act Affect Your Estate Planning?

The Tax Cuts and Jobs Act was signed into law on December 22, 2017. Below, we summarize the effect of this new tax law on your estate planning.

Good News! Gift and Estate Exclusions, and GST Exemption Temporarily Doubled!

The tax law changes in the transfer tax area are few but are very important.

The gift, estate, and GST taxes were not repealed. However, the new transfer tax laws create a window of planning opportunity:

- The \$5 million exclusion amount* for gift and estate taxes, and the GST exemption amount,* have been temporarily doubled to \$10 million.
- These new provisions “sunset” after eight years and go back to \$5 million.
- These provisions could be reduced earlier in 2020 if political winds reverse.
- So, there is a window at least for three years for single persons whose net worth is, or may be in the future, more than \$5 million, and for a married couple whose net worth is, or may be in the future, more than \$10 million, to:
 - Make gifts, and
 - Allocate GST exemption, using the temporarily large exclusion and exemption amounts.

Most experts conclude that the new law provides that there will be no “claw back” when the exclusion and exemption amounts “sunset” in eight years. That is, if you gift, or allocate GST exemption, during the eight year period, you will not lose it when the law changes back to the lower \$5 million amount. If you are in the above described net worth levels, you need to seriously consider planning now.

* These amounts are adjusted for inflation. In 2018, these amounts will probably be \$11,180,000 for a single person and \$22,360,000 for a married couple.

Gifting

Gifting moves the assets and their future income and appreciation out of the donor’s gross estate for federal estate tax purposes. That is, neither the assets, nor their income or appreciation, will be taxed under the forty percent federal estate tax rate when the donor dies.

Gifting should generally be accomplished through trusts.

- Trusts are designed to provide a dispositive plan for the family, and to name managers (trustees) who implement that dispositive plan;
- Trusts in Alaska can be perpetual, that is, they can continue from generation to generation.
- Using Alaska’s trust law, the gifts can be made to a self-settled discretionary spendthrift trust. That is, the settlor (creator of the trust) can be a discretionary beneficiary so if the settlor needs assets in the future an independent trustee can distribute assets back to the settlor.
- Trusts provide asset protection for the settlor, settlor’s spouse, children and grandchildren, and other beneficiaries. Asset protection can be critically important if a beneficiary suffers a divorce, bad investment, or a personal injury or professional malpractice claim.
- Trusts maximize tax benefits.
- Well-planned gifting often qualifies for minority interest and lack of marketability discounts, which can be thirty to forty percent. This allows for more assets to be gifted tax free. The proposed regulation that would have severely limited these discounts has been rejected by the new administration.

More Good News! The Income Tax Benefits of a Basis Adjustment Have Not Been Changed

Under existing law, when a person dies the basis of assets that person owned is adjusted to fair market value. As a result, assets may be sold without having to pay capital gains taxes, and new depreciation deductions can be taken. This is one of the few benefits of dying.

There was much concern that the new tax act would change this income tax benefit in exchange for the new gift, estate, and GST changes, but this did not happen. We get both the gift, estate tax, and GST tax benefits which double the exclusion and exemption amounts and still are able to adjust the basis of the decedent's assets at death. This is truly a "have your cake and eat it too" situation.

Updated estate planning will focus on building flexibility into your plan so that we may maximize the gift, estate, and GST tax benefits on the one hand and the income tax benefits on the other.

Allocation of GST Exemption

A generation skipping transfer occurs when assets are transferred to a generation more than one generation below the settlor's generation--for example, to a grandchild. Then the GST tax applies, which like the estate tax and gift tax is also at a forty percent rate. There is a tax exemption amount which has been \$5 million as adjusted for inflation, the same as the gift and estate tax exclusion amount. The new tax law also temporary doubles this tax exemption amount to \$10 million as adjusted for inflation. This exemption amount allows you to make gifts to grandchildren and further generations without incurring any GST tax.

- Updated planning can allocate this increased GST exemption to future gifts, whether made outright or to a trust for the benefit of a grandchild or future descendants.
- Also, this increased exemption amount can be allocated to non-exempt GST trusts which the settlor has previously formed.

Again, this is a window of opportunity as the amount could be reduced as early as 2020.

What About Persons Whose Net Worth is Less Than the \$5 Million (\$10 Million) Level?

A family's net worth, even though much lower than the above levels, is still very important and deserves careful planning. Updated estate planning will focus on:

- Maximizing income tax benefits through basis adjustment of assets;
- Asset protection for the settlor and the settlor's family (which may involve using a perpetual trust plan);
- Rethinking who are the appropriate persons or entities to be managers (trustees, personal representatives and agents); and
- Administrative provisions which need to be periodically updated as Alaska's estate and trust law is amended.
- Numerous states have in recent years enacted their own state estate tax. For example, Washington taxes estates greater than \$2 million, and Oregon taxes estates greater than \$1 million. Many people move from one state to another in the latter part of their lifetimes. For those moving to (or owning property in) a state with its own separate estate tax, careful planning needs to be accomplished to minimize the state estate tax. Use of the new increased federal exclusion amounts allows for planning which will also minimize state estate taxes.

Numerous Important Income Tax Changes Have Been Enacted

Your estate planning must consider the income tax consequences, as well as the transfer tax (gift, estate, and GST tax) effects. The new tax act has made dramatic individual income tax changes as well as changes that will affect the business entities which you own and use. Below is a brief summary of some of these significant changes:

- **Individual Income Tax:**
 - The maximum income tax rate has been lowered to thirty-seven percent.
 - The standard deduction has been roughly doubled to \$24,000 for married taxpayers filing jointly and \$12,000 for single taxpayers.
 - Personal exemptions for a taxpayer, the taxpayer's spouse, and any dependents have been eliminated.

- The mortgage interest deduction has been limited to interest on mortgage debt up to \$750,000. In addition, interest for home equity loan indebtedness is no longer deductible.
- The medical expense deduction has been retained, and such expenses are deductible if they exceed seven and one-half percent of adjusted gross income (down from ten percent).
- The deduction for state and local taxes has been limited to \$10,000.
- Miscellaneous itemized deductions that were subject to the two percent floor (employee business expenses, tax related expenses, and investment related expenses) have been suspended.
- The overall limitation on itemized deductions has been eliminated.
- Alimony will no longer be deductible for taxpayers who sign divorce agreements after December 31, 2018.
- The deduction for charitable gifts is retained and expanded to allow deductions up to sixty percent of the taxpayer's adjusted gross income (increased from fifty percent) for gifts of cash to public charities. Many taxpayers will need to "bunch" their charitable gifts in certain years in order to take advantage of the charitable deduction under the new tax law.
- Most personal casualty loss deductions have been eliminated.
- The alternate minimum income tax has been retained, but the exemption has been increased to \$109,400 for married, filing joint taxpayers and \$70,300 for single taxpayers. The thresholds for the phase-out of the exemption were increased.
- Section 529 plan distributions may now be used up to \$10,000 for tuition for the beneficiary's public, private, or religious elementary or secondary school tuition. Further, the definition of higher education expenses was expanded to include certain expenses incurred in connection with homeschooling.
- The net investment income tax was not repealed.
- The "kiddie tax" rates will now be determined by reference to the rates applicable to trusts and estates rather the rates applicable to the child's parents.

● **Business Entity Income Tax:**

- The top corporate tax rate is reduced from the current thirty-five percent to twenty-one percent.
- The corporate alternative minimum tax (AMT) is repealed.
- The expensing of depreciable assets has been increased to \$1 million.
- Net operating losses will be deductible only up to eighty percent of current taxable income.
- Section 1031 like kind exchanges will be limited to transfers of real property.
- Deductions for entertainment expenses will be disallowed, but the fifty percent limitation on deductions for meals will continue.
- A three-year holding period for carried interest will apply.
- Bonus depreciation has been increased from fifty percent to 100 percent with respect to the cost of acquiring certain new and used property.
- A new twenty percent deduction has been created for the non-wage portion of income of pass-through entities such as partnerships, limited liability companies, subchapter S corporations, and sole proprietorships.

Our goal is to work with you and your accountants to optimize your estate planning and business planning with respect to income tax as well as the transfer taxes (gift, estate, and GST taxes).

Summary

In summary, the present Congress and the Administration have sent strong signals with respect to the gift, estate, and GST taxes. These taxes are not being repealed (even in this climate when the Republicans control both houses of Congress and the Administration), nor are the exclusion and exemption amounts being permanently increased. Rather, a temporary window has been opened for those who desire to take advantage of it.

Our firm is available to help you analyze how the new tax law affects your estate planning. Please contact us to schedule a convenient time for an appointment.