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FINANCIAL CONCEPTS
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2018 Estate and Gift Tax Law

The impact of the new estate and gift tax law will force all of us to re-evaluate our current documents and the plans that we now have in place. The provisions in our wills and trusts may need to be changed to fit our asset management plans for the future. Corporate stock redemption agreements may need to be modified to help protect the family assets under the new law. This new estate tax law may also allow you to speed up the gifting of stock in the family business. And, the transition or exit plan for closely-held businesses will probably be modified to fit the new law as well.

We will be working hard during 2018 and 2019 to help our clients by discussing how this new estate and gift tax law affects their family members and their total net worth. This new law is scheduled to sunset at the end of 2025. Therefore, we have eight years to use these new rules as efficiently as possible to benefit every family that we work with.

Old 2017 Tax Brackets for Trusts

Marginal Rate	Estates & Trusts
15%	0 - $2,550
25%	$2,551 - $6,000
28%	$6,001 - $9,150
33%	$9,151 - $12,500
39.6%	Over $12,500

New 2018 Estate Income Tax and Trust Tax Brackets

Not over $2,550	10% of the taxable income
Over $2,550 but not over $9,150	$255 plus 24% of the excess over $2,550
Over $9,150 but not over $12,500	$1,839 plus 35% of the excess over $9,150
Over $12,500	$3,011.50 plus 37% of the excess over $12,500

- Trust tax rates are still very compressed and max out at $12,500, but the rates did decline in each bracket.

Lifetime Federal Estate Tax Exemption

Old Law - 2017	New Law - 2018	Planning Comments
$5.49M per individual ($10.98M for married couples). *Would have gone to $5.6M per individual and $11.2M for married couples in 2018 under old law.*	$11.2M per individual ($22.4M for married couples).	**Still have portability for the exemption. Make sure to elect portability at the passing of the basis on assets subject to estate tax.**

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		Less incentive for HNW families to do gifting for estate tax purposes. Creates good transfer planning options for business owners.

- The increase to the new exclusion amounts is repealed in 2025. The exclusion will go back to 2017 limits.

Annual Gift Tax Exclusion

Old Law - 2017	New Law - 2018	Planning Comments
Annual gift tax exclusion of $14,000 per person.	Annual gift tax exclusion of $15,000 per person.	**Higher net worth clients may need to use the annual gift exclusion and some of the estate exclusion on an annual basis.**

Review Your Will and Trust

The estate tax exemption was substantially increased in the new tax law. Because of the estate and gift tax exemption increasing from $5.6 million to $11.2 million in 2018, it may be necessary to review the provisions of your revocable living trust. For example, if you had a net worth of $7 million in 2017 and passed away, $5.4 million would normally go to your marital trust. If you are married, $1.6 million would go to the "credit trust" or "family trust". If your net worth in 2018 is $7 million, then 100% of your assets would go to your marital trust because it's less than $11.2 million and $0 would go to the credit trust, or family trust.

A couple of weeks ago I was talking to a client after reviewing his ten-year-old estate planning documents and we talked about the fact that his document said that the full amount of the estate tax exemption would go to the credit shelter trust and all the remaining assets would go to the marital trust. Since his net worth is approximately $5 million, 100% of his net worth would go to the credit trust and zero would go to the marital trust.

In the last 20 years your net worth has probably increased and the estate tax laws have changed at least ten times.

Because of the doubling of the estate and gift tax exemption to $11.2 million for both a husband and wife, and because your net worth has increased, it is important to recalculate your net worth and to understand how the language in your trust documents will control the flow of those assets.

Remember that the new exemption of $11.2 million per person, or $22.4 million per couple, is only available until December of 2025. We have eight years to use these higher exemptions as effectively as possible. We will be reviewing wills and trusts for each of our clients as we meet with them throughout 2018 and 2019.

Who Will Pay Estate Tax

According to the IRS in 2016, 12,401 estates filed a federal estate tax return which is IRS Form 706. Of those estates filing a tax return only 5,219 of those filing paid federal estate tax which totaled $18.3 billion.

If the new higher estate tax exemption had been in place in 2016, no more than 2,204 estates would have paid estate tax and the total payments would have been approximately $2.3 billion. With the new $22.4 million exemption for a married couple, the tax filings in 2016 would have dropped to 900. For comparison, in the year 2000 the federal estate tax exemption was $675,000 per person, and there were 52,000 estate tax returns that paid tax that year.

Compare Federal and State – Estate Tax Laws

Many of our clients have a net worth of less than $22 million for a married couple. Because of that, most will probably not pay any federal estate tax when both spouses are deceased. However, a lot of individual states still

have either a state estate tax, or a state inheritance tax. Because of that, the taxes being paid in the state where you live could be substantial.

Fifteen states and the District of Columbia have an estate tax. Six states have an inheritance tax, which are Iowa, Kentucky, Maryland, Nebraska, New Jersey and Pennsylvania. Maryland and New Jersey have both estate and inheritance taxes.

Many states have changed their estate tax laws over the last few years to keep up with the federal laws at that time, and some states are slow to change.

We think you should talk with your financial advisor and estate tax attorney to discuss the amount of state taxes that would have to be paid upon your death, even though the federal estate tax would be zero.

Discounts

A couple of years ago the government was trying to do away with discounting the value of minority ownership in a closely-held business especially if the stockholders were family members. Fortunately, we have been able to keep this valuable tool for business transition purposes.

For example, if a family owns a business which has been valued at $1 million and the plan is to gift 10% of the stock to their child who will be taking over the company some day, then that minority interest in the company can (and should) be discounted. 10%, or even 49% ownership of a business does not give the stockholder the ability to control the company. They do not have voting control, they cannot control their salaries and bonuses, and cannot control business decisions. The discounting of the value for a minority ownership in a privately-held business has been between 10% and 32%. If agricultural or forestry land is involved, then perhaps the discount might be higher. Therefore, 10% of the business valuation would be $100,000, but after taking the normal discount for lack of voting control and lack of marketability, the discounted value would be closer to $70,000. This means that the business owner would use less of the estate and gift tax exemption. If the business was valued at $10 million, then 10% would be $1 million, and using the same discounts the gift would be valued, under this method, at about $700,000.

Discounting the value of a business for minority stockholders is very important and it is a valuable tool for transitioning S corp stock, C corp stock, limited liability company units, and limited partnership interests from one generation to the next. It is an important estate planning tool that we use every day.

Step Up in Basis

The new estate and gift tax law did not change the rules for step up in basis at death. That means if someone dies with an asset that they paid $100,000 for, and the asset is now valued at $300,000, then upon death the value of the asset takes a step up in basis to $300,000. There would be no capital gains paid if the asset was sold at that higher value.

This is another very important planning tool that we use for families that have assets which may appreciate rapidly over the next five to ten years.

For example, if one of our clients has a closely-held business that is growing at approximately 12% to 15% per year, they may want to gift some of that stock to other family members, or trusts, in order to get future appreciation out of their taxable estate. At the same time, if that client has an asset that is growing at 2% or 3% per year, and producing excellent income through lease payments, interest or dividends, then that slow-growing asset may be kept by the older generation.

Reviewing the growth potential of every asset is an important part of the estate planning process and we are glad that we still have this option to use with our clients when appropriate.

Kiddie Tax

Under the prior federal tax rules, children who were under the age of 19 (or under the age of 24 if they were a full-time student) and had un-earned income, would be taxed on that income at their parent's highest income tax rate. For example, if the grandparents of the children established a trust with investment assets, and the trust earned interest and dividends which were distributed to the children, the children would claim that "un-earned" income on their personal tax return. This "kiddie tax" requires that the income is to be taxed at the their parent's highest tax bracket.

Under the new 2018 income tax laws, the kiddie tax law has changed. Now, the un-earned income will be subject to current trust tax rates instead of the children's parent's tax rate. The trust tax rates can be much higher and more compressed than the parent's tax rates.

For example, if a child received $15,000 of income from a trust in 2018 of which half was interest income and the other half was qualified dividends, the interest income would be almost immediately taxed at a rate of 37%. The dividends would be taxed at 20%. That same income could have been taxed at a lower rate if the income was only subject to the child's parents who are earning under $200,000 of income.

Many of our clients have established trusts over the years for their children and grandchildren. Now we are in the process of looking at those trust documents and working with our clients and their attorneys to see if anything should be modified in order to protect the trust assets and the income for the family.

Disclosures:
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