Estate Planning Update | December 2018

By Warwick Carter, Special Advisor

As the end of 2018 approaches, financial advisors and clients would be smart to focus on strategies to save taxes before the end of the year and into the New Year. This year presents many new opportunities given the passage of the Tax Cuts and Jobs Act (TCJA) just one year ago. 2018 is the first year in which Americans will be affected by the new Trump-era tax law and there are many changes that will affect us all. Here are some year-end strategies that we thought you should think about now:

1. **Tax-loss harvesting:** This is not a new idea but is one that bears reminding every year in December. Capital losses (other than wash sales) will offset capital gains taken earlier in the year and reduce your taxes. At Spruce, we have been doing this all year long for clients.

2. **IRAs:** If you are currently taking the Required Minimum Distribution (RMD) from your IRA, you can make a direct contribution to a qualified charity from your IRA up to $100,000 and still meet your RMD. None of the donated funds will be taken into income taxable income. However, gifts to Donor Advised Funds and private foundations do not qualify under this rule.

3. **Charitable deduction:** Consider making a larger than normal charitable gift to a Donor Advised Fund so as to increase your overall itemized deductions. Because of the $10,000 limit on the state and local tax deduction, the charitable deduction will play a bigger role this year. However, total itemized deductions must exceed $12,000 (or $24,000 for a married couple filing jointly) in order to be deductible due to the new higher standard deduction.

4. **New estate tax exemption:** The Federal estate and gift tax exemption is currently $11.18 million per person. In Connecticut, the state exemption is $2.6 million. The IRS has recently announced that anyone who makes a taxable gift that is offset by the exemption will not have to worry about a potential “claw back” of previously untaxed gifts if the exemption returns to the old level when the law sunsets on December 31, 2025. This is good news for famlies with wealth over $25 million (which we see as a mimium threshold for making large taxable gifts).

5. **State estate tax changes:** On January 1, 2019, the Federal and Connecticut exemptions will increase to $11.4 million and $3.6 million, respectively. As of January 1, 2019, gifts will not be brought back into the estate of a New York resident when computing New York estate taxes. Under a transitional rule, New York’s estate tax had a look-back period that picks up gifts made within three years of death if the gift was made between April 1, 2014 and December 31, 2018. That rule will no longer apply after the end of this year.

6. **Annual gift exclusion:** The annual gift tax exclusion is $15,000. You can make gifts up to that amount to an unlimited number of individuals. Husband and wife can give twice that amount (or $30,000). All funds can come from one spouse if they elect to split gifts on their gift tax returns (due April15 of the year following the gift).

7. **529 Plans:** Consider adding funds to a 529 College Savings Plan. These plans allow tax-free appreciation of assets set aside for higher education. The 529 Plan in Connecticut is called CHET and a state income tax deduction up to $5,000 may be available ($10,000 for couples). Federal law allows you to front-load gifts to a 529 Plan by making five years' worth of tax-free gifts in a single year (up to $75,000, or $150,000 if both husband and wife make the gift). Under the TCJA, tuition for K-12 schools (up to a cap of $10,000 per year) may be paid from a 529 plan. In addition, Section 529 rules permit you to change the Plan's beneficiary to another family member if that is desirable.

8. **Stepped-up basis:** Under current rules, all property held at death gets a "stepped-up" income tax basis. That means that appreciated property is marked to its fair market value when the owner passes away and only a minimal (or possibly no) capital gains tax would be due after the sale of the property. This rule, combined with a high federal estate tax exemption, allows high net-worth families to transfer a tremendous amount of wealth free of federal estate and gift taxes.

   Creative planners are recommending "upstream gifts" to parents or grandparents in order to achieve a basis step up. In some cases, irrevocable trusts can be terminated early, modified or decanted to achieve a stepped-up basis when a beneficiary dies. However, watch out for the one-year rule: assets that you give away and get back within one year of the donee's death do not get the benefit of a basis step up. *Note: Connecitcut residents should be aware that the state still has a gift tax.*

9. **Plan ahead for tax season 2019:** Work with your accountant to make sure you are on track to pay your 2018 income taxes by April 15, 2019. Because the new tax act eliminated (or reduced) many familiar tax deductions, some taxpayers may find themselves owing more than they expect next April. There is also a new (and very comeplex) set of rules that allow cetain small business owners to deduct 20% of qualified business income. The new section 199A rules are among the most complex in the tax code and require a tax professional to navigate them.

10. **Update your estate plan:** 2019 will be a good year to update your estate plan. The passage of the TCJA has rendered many estate plans out of date. Many wills and trusts employ formula clauses that are geared to the lower estate tax exemption amount that existed prior to 2018. As a result, an old will or trust could cause a credit shelter trust to be over-funded and a marital trust to be under-funded. We advise having your attorney take a look at your plan and make sure it's still current or refresh the plan in light of recent changes in the law. The New Year presents a great opportunity to focus on estate planning.

At Spruce, we are closely monitoring developments in the tax law that affect our clients. We hope this year-end Estate Planning Update is helpful. As always, if you have any questions about this Update or wish to discuss these and other ideas further, please don't hesitate to reach out to any of us.

John, Michael, Warwick and your Spruce Team

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