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Estate Planning After Tax Reform: Debunking Myths That Everyone Still Accepts

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Federal Estate Tax

History – Estate Tax Exemption

Year	Exemption	Top Tax Rate
1997	$600,000	55%
2002	$1,000,000	50%
2004	$1,500,000	48%
2006	$2,000,000	46%
2009	$3,500,000	45%
2010	$5,000,000	35%
2017	$5,490,000	40%
2019	$11,400,000	40%

Number of Returns Filed

Year	Number of Returns	Number of Taxable Returns	Estate Tax Liability ($ billions)
2001	109,600	50,500	$23.7
2007	36,700	16,600	$24.6
2008	29,000	15,100	$18.9
2009	12,900	5,700	$13.6
2010	*	*	*
2011	9,400	4,400	$10.9
2012	9,600	4,100	$12.0
2013	11,300	4,700	$16.6
2014	11,000	5,400	$18.3
2015	11,000	5,300	$18.6
2016	11,200	5,300	$19.3
2017	11,300	5,500	$20.0
2018	4,000	1,900	$14.9

* 2010: There was no estate tax in this year.

Current Exemption

- **<u>Tax Cuts and Jobs Act (TCJA)</u>**: for 2019, the lifetime exemption increased to $11,400,000 per person.
  - This exemption is set to be cut in half by 2026, when the TCJA expires.

- **<u>Portability</u>**: the unused portion of your exemption can be transferred to the surviving spouse at the time of death.
  - Married couples have an exemption up to $22,800,000.
  - (Note: Portability is disallowed in New York State)

Gifting

- Annual gift exclusion is $15,000 per person per year. Married couples can gift a total of $30,000 of nontaxable gifts to each individual they choose.
- Gifts made reduce your taxable estate (See New York issues).
- With the new estate tax exemption set to expire in 7 years, making gifts before 2026 can reduce your taxable estate before the law changes.
  - Keep in mind that 7 years is a long time. Laws can change between now and when the TCJA expires.

18 States with Scary Death Taxes

State	Estate or Inheritance Tax	Notes
Connecticut	Estate Tax (7-12%)	Gift tax applicable on assets you give away while you are alive. Tax due on estate is limited to $15 million.
DC	Estate Tax (12-16%)	Has a $5,681,760 exclusion but the percentage is high for the lowest bracket.
Hawaii	Estate Tax (10-15.7%)	Has a $5,490,000 exclusion but by 2020, the highest rate creeps up to 20% for estates above $10 million.
Illinois	Estate Tax (0.8-16%)	Has a $4 million exclusion, amount is not adjusted for inflation.
Iowa	Inheritance Tax (5-15%)	No tax due for children or stepchildren, but there is a tax on brothers and sisters, aunts and uncles.
Kentucky	Inheritance Tax (4-16%)	Decedent's spouse, parents, children, grandchildren and siblings pay not tax. All other heirs are taxed w/ $500-1,000 exemption.
Maine	Estate Tax (8-12%)	Has a $5.7 million exemption, with a top rate of 12%.
Maryland	Estate (0.8-16%) & Inheritance Tax (10%)	Has an exemption of $5 million for estate tax, along with a 10% flat inheritance tax. Some heirs are exempt.
Massachusetts	Estate Tax (0.8-16%)	Exemption is stuck at $1 million with top tax rate of 16%.
Minnesota	Estate Tax (13-16%)	Has an exemption of $2.7 million. Has a 3-year “clawback” period for any taxable gifts made.
Nebraska	Inheritance Tax (1-18%)	The closer the heir's relationship to the decedent, the smaller the tax rate they have.
New Jersey	Inheritance Tax (11-16%)	Decedent’s spouse, children, and grandchildren have no tax. Other heirs have tax with rate ranging from 11-16%.
New York	Estate Tax (3.1-16%)	Has a $5.74 million exemption but has a “cliff-tax” (entire exemption phased out if your estate is above threshold)
Oregon	Estate Tax (10-16%)	Only a $1 million exemption with a 10% beginning rate for the smaller taxable estates.
Pennsylvania	Inheritance Tax (4.5-15%)	4.5% rate for direct descendants, 12% rate for siblings, and 15% rate for all other heirs.
Rhode Island	Estate Tax (0.8-16%)	Only a $1,561,719 exemption, although it adjusts the exemption for inflation.
Vermont	Estate Tax (16%)	Has a $2.75 exemption, but has a flat tax rate of 16%, no matter the size of your estate.
Washington	Estate Tax (10-20%)	Has a $2.193 million exemption, indexed to inflation. Very high, top tax bracket for larger estates.

New York State Estate Tax

NYS Estate Tax Issues

- Unlike some states, New York does not have an inheritance tax but has an estate tax instead.
- The exemption amount is $5,250,000 (did not increase like the federal did).
- Portability – NO!!
- Cliff Tax – YES!!
- “Clawback” Period for gifting

NYS Estate Tax

- With the exemption amount much lower than the federal, people might be subject to NYS estate tax even if they aren't subject to federal.
- Unlimited Marital Deduction: often used so there will be no federal or state estate tax at the death of the first spouse.
  - Planning needed.
- Need to balance the estate:
  - When the second spouse dies, the entire estate is passed down to their children or beneficiaries and taxed – no second exemption.

Portability

- New York State does not allow portability.
- The remaining exemption amount does not get transferred to the surviving spouse at the time of death, unlike how it does for federal purposes.
- A Way Around This:
  - An exemption trust, or credit shelter trust can be set up so both exemptions are fully used.
  - Problem with this: it is one-way. If the spouse without assets passes first, this type of trust would be pointless.
  - Balancing the estate is still an option.

Cliff Tax

- NYS exemption amount is phased out immediately if the estate exceeds 105% of the exemption amount ($5,512,500).
- This is what is called the **Cliff Tax** – it is a bad thing
- Planning Technique: If an individual is barely above the exemption amount, through their will or trust, they may gift the amount above the threshold to a charity to push them below the threshold amount.
  - Must be careful when doing this. If your taxable estate grows before you die, you will want to review the will.
  - Planning is necessary.

Example of the Cliff Tax

- It is determined that an individual's taxable estate in NY is $5,540,000, $27,500 above the exemption threshold. With NY's cliff tax, that individual's estate would be taxed on $5,540,000, and not $27,500, the amount above the threshold. They would end up owing $455,600 in tax.
- If $27,500 was gifted to charity at the time of death through a will, then there would be no estate tax because they would be below the threshold amount. This would save them $455,600 in taxes all because they gifted $27,500 to charity.
- Keep in mind that wills and trusts should be updated regularly based on if your estate has grown or declined.

"Clawback" Period

- Any gift of assets made to an individual are tax free and will decrease their residual taxable estate amount.
- NYS created a 3-year clawback provision because of this.
- <u>"Clawback" Period</u>: provision by NYS that disallows gifts to be deducted from an individual's estate if the gift was made within 3 years of the donor's death.

Non-Tax Estate Planning Issues

Non-Tax Considerations

Why a will is necessary:

- Custody of minor children upon death of their custodial parents, as well as custody of the assets.
  - It is smart to separate the two, so one person doesn't have control of both.
- Determine charitable goals and objectives – to whom, how much, etc.
- How assets will be administered for the benefit of a surviving spouse/children/charities, as well as tax issues regarding them.
- Determination of which heirs will receive estate assets after second death.
  - Divorces will complicate this; will assets go to ex-spouse, your children, or stepchildren?

Non-Tax Considerations (cont.)

- Structuring of asset distributions, whether in a will or through a trust.
- Structuring asset ownership to avoid probate, want continued flexibility.
- Addressing complex family structures, including second marriages, children with different spouses, and stepchildren.
- Addressing special needs or financially irresponsible family members.
  - May need to set up a trust that only gives money under certain circumstances (ex. College, buying a house, etc.), or by consent.

Non-Tax Considerations (cont.)

Non-will items:

- Drafting a durable financial power of attorney which should be updated periodically.
  - Lets the person of your choosing make financial decisions should you become unable to make decisions yourself.
- Drafting a health care Power of Attorney and living will.
- Review beneficiary designations on life insurance policies, retirement accounts, bank accounts, deeds, etc.
  - Should review these periodically and make necessary changes.

Other Estate Planning Issues

- All documents should be examined and where called for, updated.
- Because of new laws, changes in taxes and situations may have altered.
  - Update wills, and maybe move assets into a trust (revocable or irrevocable).
  - Update trusts that have formed under old law. May need a lawyer for this.
    - Merging an old trust with a new one for better provisions (decanting).
  - Update life insurance policies
    - May have went through a life event and beneficiaries need to be updated.
  - Keep in mind beneficiaries to your wills, trusts, life insurance policies, pensions, etc.

Trust Planning

Basic Reasons for Trusts

- Delaying Inheritance: Set up a trust so that it distributes assets at a certain age/time.
- Asset Protection: Protect assets from creditors like a divorcing spouse or a lawsuit. Independent trustee can make distributions.
- Planning for Special Assets: Interests in a family business. Facilitates succession planning to ensure business stays within the family.
- Probate avoidance: Transferring assets into a trust may avoid the probate process. Assets in probate requires more work and will cost money and time to deal with it.

Revocable Trusts

- Provisions and assets within this trust can be altered or cancelled dependent on the grantor.
- During life of trust, income earned is distributed to the grantor; the property is transferred to the beneficiaries at the death of grantor.
- There are many different options with this type of trust. It can be set up multiple different ways.
- Since beneficiaries are named at the death of the grantor, it keeps the assets out of probate.

Irrevocable Trusts

- Terms cannot be modified, amended or terminated without permission of the grantor’s named beneficiaries.
- The grantor effectively transfers all ownership of assets into the trust.
- This removes assets from the grantor’s taxable estate.
- Relieves the grantor of tax liability on the income that the assets generate.
- Offers protection of assets against creditors.

Reasons to do Estate Planning

- Piece of mind
- Name your executor
- Help plan your needs/retirement
- No unintended beneficiaries
- Keeps the peace within the family
- Reduce future estate tax problems

Importance of Reviewing Existing Wills

- Wills will carry out your planning objectives.
- Situations change constantly.
- What was good for you 10 years ago, may not be anymore.
- Estates can grow or decline as time goes on
    - Should review, and update if necessary, every 5 – 10 years

Questions

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