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Newsletters

Estate Planning Newsletter - December 2018

December 11, 2018

Welcome to the *Hinshaw Estate Planning Newsletter*, designed to help you stay up to date on current estate planning topics, as well as other relevant legal developments and trends.

As we approach the holiday season, the Hinshaw Estate Planning team is excited to share another set of end-of-year estate planning tips. Here, we take a look at charitable contributions, asset protection, changes to 529 (education savings) Plans, disposal of digital assets (e.g. that Instagram account you forgot about), considerations for closely held business owners, and portability issues (no, it has nothing to do with holiday season packing).

If you have any questions about these topics, contact your Hinshaw estate planning attorney or tax professional.

Year End Reminder: Review Your Estate Plan

When did you last review your estate planning documents? Laws, family circumstances and your personal preferences may change over time, and these changes can have an important impact on your estate plan. Also, individuals named to serve as executor/personal representative, trustee or guardian may no longer be appropriate, formulas for tax savings may no longer be accurate (or may cause taxes to be incurred that could otherwise be avoided or delayed), beneficiaries' circumstances may have changed or designated beneficiaries, like relatives or charities, may no longer exist due to death or dissolution. These issues can cause your estate to incur extra costs.

When the designation of a beneficiary fails for some reason, the trustee or executor may need to petition a local court for an interpretation based upon the provisions of the trust/will and the surrounding circumstances to determine who or what should be the appropriate beneficiary, or provisions of state law may dictate who should receive your assets. This, of course, may not be what you intended. A simple review and update of your estate planning documents, including beneficiary designations on IRAs, 401(k) accounts, life insurance and other accounts where a beneficiary has been designated, can save your surviving loved ones time, trouble and money in the future. If you haven't reviewed your estate plan in a while, get ahead of your New Year's resolutions and contact your estate planning attorney before the holidays to set up an appointment.

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Service Areas

Estate Planning & Wealth Preservation

Charitable Contributions in Income Tax Planning

Use Retirement Assets

If you are 70 ½ or older, you can contribute directly from an IRA to a charity and avoid paying income taxes on the distribution. Since you have to begin taking Required Minimum Distributions (RMDs) at 70 ½ from your IRA regardless, this method makes a lot of sense for accomplishing some or all of your charitable donations. The charity benefits from receiving the amount that you otherwise would have paid in income taxes on the RMD. The donation limit is $100,000. This form of contribution is called a Qualified Charitable Distribution, which must be made directly from the IRA custodian to the charity. Please note, you cannot deduct as an itemized charitable deduction the amount received by the charity via a Qualified Charitable Distribution.

Year End Gifting

Bunching charitable gifts as an itemized tax deduction can be a good strategy for people who ordinarily do not make charitable gifts large enough to exceed the standard deduction ($12,000 for an individual or $24,000 for a couple for state and local taxes, mortgage interest and the deductible portion of medical expenses). For example a couple may want to bunch their donations so that they contribute $20,000 every other year if that amount will ensure that their itemized deductions will be in excess of the standard deduction, and nothing in the next year when the standard deduction will be utilized.

If 2018 is the year you want to make the extraordinary contributions, they need to be sent early enough to be received and processed before year-end. The charity's written acknowledgement of the gift needs to state it was received in 2018.

Charitable Contributions in Estate Planning

Consider Using an IRA Beneficiary Designation

Above we provided suggestions that should *also* be considered when planning your estate. You may wish to leave a substantial sum of money to your favorite charity such as your alma mater, student scholarship fund, etc. as part of your estate plan, however, if you simply make a cash gift in your Will to the charity—and a spouse, child or other individual is listed as a beneficiary in your Traditional IRA or other qualified retirement plan—the individual designated as a beneficiary will have to pay income tax on the funds received from the IRA or qualified retirement plan (no taxes will be due if it is a Roth IRA or Roth 401(k) account). To avoid this tax liability, consider making the gift out of your Traditional IRA or qualified retirement plan to the charity of your choice. This will allow your individual beneficiary to receive assets that are not subject to income taxes. Since a charity does not have to pay income taxes on the assets it will receive from your IRA or other qualified retirement plan, no income tax will be incurred thereby increasing the total after tax assets available to benefit your beneficiaries who are not charities.

529 Plans

If you have a grandchild or other family member or other favorite youngster expecting to go to college one day, you might want to consider contributing to a 529 Plan on their behalf. Recent changes allowing for use of plan funds beyond college or vocational training expenses may provide another incentive to invest. 529 Plans allow parents, grandparents and others to contribute to an investment account in which funds can grow income tax free in order to save for future education costs on behalf of a beneficiary, regardless of whether or not the beneficiary is related to the contributor. Contributions are not deductible for federal income tax purposes, but many states allow a limited deduction or credit against state income taxes. Earnings and capital gains are not taxable during the life of the account. Amounts withdrawn from the account are not taxable as long as the funds are used for educational expenses of the beneficiary. Historically, education expenses had to be used for college or vocational training, but beginning in 2018, up to $10,000 per year of funds in these accounts can be used for elementary or secondary school expenses.

Principal advantages of these Plans are that there are no eligibility restrictions and contribution limits are simply defined as the amount reasonably necessary to provide for the education of the beneficiary. Contributions to these Plans are considered completed gifts which reduce your estate, even though you retain the right to change the beneficiary to another qualifying family member, or even take the money back (which would incur taxes and a 10% penalty on the increase in value). Significant contributions may require gift tax returns, although there is a provision that allows a $75,000 contribution per contributor to a 529 Plan every 5 years without incurring a gift tax. Note that this election must be filed on a Form 709 Gift Tax Return. Disadvantages of 529 Plans include the fact that they must be funded with cash rather than stock or other assets, and the investment alternatives are limited to the Plan's available portfolios of mutual funds.

Eligible education expenses include tuition, fees, books, supplies and equipment—including a computer. Room and board is also included if the student attends school more than half time. There are limits on the amount of off-campus housing costs that can qualify, but no limits if your student resides in school-owned housing.

Asset Protection for Everyone

It is a common misconception that only certain high risk professionals such as doctors need legal advice on protecting their assets. In fact, if you drive a car, for instance, your negligence could result in a judgment for millions of dollars in damages, far exceeding your automobile owner liability policy limits. Umbrella liability policies are easy to obtain and provide the most economical way to avoid a catastrophic judgment that would otherwise strip you of your life savings. The requirements include an automobile policy and a homeowner's insurance policy with minimum coverage as specified by the umbrella liability insurer. It is recommended that coverage be at least $2 million, but $5 million is better. In many cases, a creditor who might reasonably anticipate a much larger judgment will settle for a quick payout at the policy limit as opposed to engaging in time consuming litigation and expensive efforts to reach other assets such as real estate or a business.

Digital Assets after Death

Have you ever wondered what will happen to your various internet accounts when you die? Each of us routinely checks the "I accept" box in the terms of service agreements whenever we open an account, but who actually reads those? Generally, they limit or deny access to an account to anyone other than the subscriber. Several states have passed a version of a Uniform Law (Uniform Fiduciary Access to Digital Assets Act) that seeks to provide a remedy for this for an executor or trustee. You can also empower your executor/trustee with language in your Will or Trust. Contact your estate planner to review your documents and add such a provision or update the language to take advantage of the Uniform Law if available in your state.

Closely Held Businesses

Are you a business owner or do you plan on starting a new business? For many years, the entity "of choice" for small business owners was the limited liability company which is taxed as a partnership meaning there is no entity level tax, and all income is subject to income tax at the rate assessed against each of the owners for their share of the income. However, the Tax Cuts and Jobs Act of 2017 changed the playing field. Section 199A has now made a "C" Corporation a more viable and potentially more valuable option in certain circumstances due to a reduced tax rate on income of the corporation, with the top rate at 21% as compared to 37% for individuals. There are many complex rules, so you should consult your Hinshaw lawyer and tax advisor to determine what may be best in your particular situation.

The Dreaded "Clawback" Tax Does Not Apply to Lifetime Gifts

On November 23, 2018, the IRS issued proposed regulations that help resolve a question raised by the federal tax cuts of 2017 related to the estate and gift tax exemption levels. As you may be aware, the federal estate and gift tax exemption was approximately $5.49 million per person in 2017, and under the Tax Cuts and Jobs Act (TCJA) passed last winter, the exemption was increased to $11.18 million (which is to be indexed for inflation) per person. For 2019, the exemption will be $11.4 million per person. However, the concern for high net worth individuals is that the TCJA sunsets in 2025 and the higher exemption amount would decrease back to the lower levels of 2017 (to be adjusted for inflation at that time). This raised the question of whether gifts made while the higher exemption levels were in place would be taxed at the person's death after 2025 when the exemption amount decreases—the dreaded "clawback." The IRS has now indicated in its proposed regulations that there will be no "clawback" of lifetime gifts—meaning that you can make gifts now without fear of being taxed later! It should be noted that there is a hearing set for March 13, 2019 on these proposed rules, which may result in changes. Please keep in touch with your Hinshaw estate planning attorney as this develops further. You should consider using the increased exemption amounts before you lose them!

Portability

As we mentioned above, The Federal Estate Tax law currently provides for a very sizeable exclusion of $11.18 million per person before an estate is subject to federal estate taxes. And if it is not repealed and replaced earlier, that exclusion will sunset in 2025. For an estate that could exceed this individual exemption limit, portability provides some flexibility. The portability concept allows a surviving spouse to use a deceased spouse's unused estate tax exemption with the following caveat: an estate tax return must be filed at the death of the first spouse, even if no tax is due. This allows for the determination of the unused estate tax amount available to the surviving spouse. Note, your decision to preserve the unused exemption should not be governed solely by the current high exclusion limit, since it will disappear in 2025 if not extended by law, or could be lowered due to the need to address extremely high national debt or due to a change of administration or control of Congress.

Flexibility of Retirement Plan Beneficiary Designations

A very large portion of most peoples' investments are now held in qualified retirement plans. This presents a dilemma, because under present Federal income tax laws, it is most advantageous to designate the surviving spouse as the primary beneficiary, and then list the client's adult children as contingent beneficiaries. By making this designation, the surviving spouse has the ability to defer the income taxes on such investments until he/she attains a certain age. If the adult children are designated as contingent beneficiaries, they also have the ability to defer the income taxes on said inherited retirement plan accounts, but they must take a required minimum distribution based upon each child's life expectancy as determined by IRS tables.

Many of our clients ask whether they can designate a trust as the beneficiary of a retirement plan for the benefit of their children. The answer is "Yes," and this is accomplished by setting up a conduit trust for each child beneficiary, achieving two primary goals. The first goal is income tax deferral and the second goal is that a third party would have control over the funds and important decisions affecting the funds so that the child's inheritance is protected. If the trust is designed correctly, and the documentation is provided to the retirement plan custodian within a certain period of time after the death of a client, then the trust would qualify to receive distributions over the life expectancy of the child beneficiary and qualify as a "stretch out" trust that achieves both of the client's objectives.

As you are making decisions about your estate or are considering any tax implications with your annual gifting, please contact your Hinshaw estate planning attorney or tax professional. We are here to answer your questions!