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ADVISORY

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PRIVATE CLIENT SERVICES 2018 YEAR-END ADVISORY

This past year was filled with noteworthy changes to our tax landscape. In this Advisory, we summarize major changes enacted in the Tax Cuts and Jobs Act and outline a number of recommended estate planning opportunities before the end of the year.

2019 ESTATE, GIFT AND GST TAX EXEMPTION

For tax year 2019, the estate, gift, and generation-skipping transfer ("GST") tax exemption amounts are projected to be as follows:

Unified Federal Estate, Gift Tax and GST Exemption. In 2019, the estate, gift tax and GST exemptions are projected to be $11,400,000 per taxpayer, this is up from $11,180,000 in 2018. A married couple will be able to shield a total of $22,800,000 from these taxes in 2019, up from $22,360,000 in 2018. These exemption amounts are set to expire after December 31, 2025. On January 1, 2026, the exemption amounts will revert back to prior law, $5,000,000 per person, indexed for inflation from 2011.

40% Estate, Gift and GST Tax Rate. The maximum estate, gift, and GST tax rate will remain at 40%.

Annual Exclusion from Gift Tax. The gift tax annual exclusion amount will remain at $15,000 in 2019. Consequently, a married couple can gift up to $30,000 per calendar year, with no estate or gift tax consequences. The gift exclusion between spouses is unlimited if both spouses are U.S. citizens. The exclusion for gifts made to a spouse who is not a citizen of the United States is projected to be $155,000, up from $152,000 in 2018.

Connecticut Unified Estate and Gift Tax Exemption. In 2019, the Connecticut estate and gift tax will rise to $3,600,000, a substantial increase from $2,600,000 in 2018.

New York Estate Tax Exemption. In 2019, the New York estate tax exemption is expected to rise to $5,740,000, an increase from $5,250,000 in 2018. The maximum estate tax rate will be 16%. However, the seemingly high exemption amount can be misleading because if your taxable estate at the time of your death is greater than 105% of the value of the exemption, then the exemption is completely phased out. In effect, this estate tax "cliff" will subject your entire estate to New York estate tax.

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Repeal of New Jersey Estate Tax. The New Jersey Estate Tax was repealed as of January 1, 2018. The New Jersey "inheritance tax," however, is still in effect. This is a tax imposed on transfers to beneficiaries who are not spouses, parents, children or grandchildren. Current inheritance tax rates depend on the amount received by each beneficiary or transferee; the rates range from 11% to 16%. No tax is due for transfers of $500 or less.

TAX CUTS AND JOBS ACT

In January of 2018, the Tax Cuts and Jobs Act (the "Tax Act"), went into effect and was considered one of the most extensive overhauls of the United States Tax Code in more than three decades.

As enacted the Tax Act:

- Almost doubles the standard income tax deduction to $12,000 for single filers, $18,000 for heads of household, and $24,000 for married couples filing jointly;
- Limits the deduction for state and local taxes to $10,000;
- Raises the child tax credit from $1,000 to $2,000 for each child and increases the income level above which the credit is phased out from $110,000 to $400,000 for married couples, and from $75,000 to $200,000 for single parents;
- Limits the mortgage interest deduction to interest incurred on the first $750,000 of principal value and any interest on home equity loans or lines of credit is no longer deductible unless the borrowed funds are used to buy, build, or substantially improve the tax payer's home that secures the loan;
  - Under a grandfather rule, the Tax Act does not affect home acquisition debt of up to $1 million that was taken out before December 15, 2017 or under a binding contract that was in effect before December 15, 2017, as long as the home purchase closed before April 1, 2018;
- Requires that, starting in 2019, medical expenses must exceed 10% of adjusted gross income (AGI) to be deductible (in 2018, you may deduct medical expenses that exceed 7.5% of AGI);
- Increases the percentage of income limits on deductions for certain charitable gifts (you may deduct up to 60% of your AGI for gifts of cash to public charities, up from the prior 50% limit);
- Raises the exemption level for the Alternative Minimum Tax (AMT) to $109,400 for married couples, up from $86,200, and to $70,300 for individuals, up from $54,300. The AMT exemption rate, however, is subject to inflation and these rates are expected to increase in 2019;
- Retains the deduction for student loan interest;
- Removes the deduction for tax preparation expenses, moving expenses, and the payments of alimony made pursuant to agreements signed after December 31, 2018; and
- Repeals the penalty on individuals who do not purchase health insurance.

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Overall, the Tax Cuts and Jobs Act is a major tax reform that affects individuals, businesses, and tax exempt and government entities. It is important to be cognizant of the current tax environment and anticipate changes to how your 2018 federal income tax liability will be determined.

YEAR-END PLANNING OPPORTUNITIES

1. Utilizing Your Annual Gift Tax Exclusion

Currently, under the federal gift tax laws, each taxpayer is entitled to give up to $15,000 to any number of people without paying any sort of gift tax consequence and without reducing any portion of his or her lifetime exemption. Therefore, in 2018, a married couple is able to give up to $30,000 to each of their children and/or other individuals without having any sort of tax consequences for such gift. The gift can be made in a variety of ways, such as outright cash distributions, marketable securities, or tangible personal property. An appraisal may be needed to value assets other than cash or marketable securities.

Any gift made by check, however, must be cashed or deposited prior to the end of 2018 for it to count toward the annual exemption for 2018.

Annual exclusion gifts may be used to fund Section 529 education savings plans ("529 accounts") for children, grandchildren, and other individuals. The contributed funds can grow tax-free and can be withdrawn tax-free as long as the funds are used to pay for the beneficiary's education. One of the recent Tax Act changes allows distributions of 529 accounts to be used to pay up to a total of $10,000 per year of tuition per beneficiary at an elementary or secondary public, private, or religious school of the beneficiary's choosing. Otherwise, the 529 account funds are to be used to pay for college, graduate school or other accredited schools.

The recent Tax Act allows funds to be rolled over from a designated beneficiary's 529 account to an ABLE account for the same beneficiary or a family member. ABLE accounts are tax-favored accounts for individuals who become disabled before age 26, and are designed to enable these individuals and their families to save and pay for disability-related expenses. Annual contributions are limited to $15,000.

Donors may also want to keep in mind two specific exceptions to the gift tax:

- First, tuition may be paid on behalf of an individual directly to an educational institution without incurring any gift tax consequences. Reimbursement of tuition expenses to the benefitted individual will be treated as a gift for gift tax purposes, but direct payments to the educational institution will not. While this exception only applies to tuition, funds held in a 529 account can be used to pay other education expenses, such as room and board, books and related items.

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- Second, medical expenses may be paid on behalf of an individual directly to the provider also without incurring any gift tax liability. In order to qualify, such medical expenses must not be paid by an insurance company and cannot be reimbursable by insurance. This exception includes payments for prescription drugs; expenses related to the diagnosis, cure, mitigation, treatment or prevention of disease; transportation essential to medical care; and premiums for medical insurance.

Connecticut residents should be aware that Connecticut imposes its own gift tax, and it is enforced on the transfer of property by gift during each calendar year. The Connecticut gift tax annual exclusion mirrors the federal gift tax annual exclusion and generally follows the same rules. The tax rate on gifts over the Connecticut lifetime gift tax exemption of $2,600,000 ranges from 7.8% to 12%.

2. Distributions from Non-Grantor Trusts

Trustees of irrevocable trusts taxed as "complex trusts" should consider making income distributions to those beneficiaries that might be in lower tax brackets. This type of distribution may avoid the imposition of the investment income surtax. Moreover, Trustees should determine whether or not it is permissible and beneficial to distribute capital gain income to beneficiaries in lower income tax brackets. Such distributions can be made within the first 65 days of 2019 if the Trustee elects to treat the distribution as occurring at the end of 2018.

3. Tax-Efficient Charitable Giving

Giving appreciated assets (assets that will incur capital gains tax upon sale) directly to a charity is a simple and tax efficient method of achieving your philanthropic goals. In most cases, you can claim an income tax deduction based on the fair market value of the property contributed, and a qualified charitable organization will not incur capital gains tax when it sells the property. For taxpayers in higher tax brackets, gifting appreciated assets to charity in 2018 and beyond can be an effective way to avoid capital gains tax and the 3.8% Medicare surtax.

Current law also allows individuals over the age of 70½ to direct up to $100,000 to be distributed from an individual retirement account ("IRA") to charity, without paying any tax on the transaction. In order to qualify, the transfer must be made from the IRA directly to the charity.

With the increase in the standard deduction, taxpayers can only deduct charitable contributions if they itemize deductions. Without itemizing, taxpayers receive no income tax benefit from charitable donations. Individuals should consider doubling up their contributions one year, and reducing them the following year in order to take an itemized deduction the first year and taking the standard deduction the next year. By grouping your charitable gifts you can maximize your ability to take an itemized deduction.

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This publication is a summary of legal principles. Nothing in this article constitutes legal advice, which can only be obtained as a result of a personal consultation with an attorney. The information published here is believed accurate at the time of publication, but is subject to change and does not purport to be a complete statement of all relevant issues.

In order to qualify for the aforementioned benefits, the recipient organization must be recognized by the IRS as a qualified charitable organization. If you are unsure about the status of a charity, we recommend that you request from the organization a copy of the organization's qualifying letter from the IRS. Usually, you can check this information online. See IRS Publication 78.

4. Final Thoughts

As the end of 2018 approaches, we urge you to review your estate planning documents and consider whether they need updating. Below is a list of questions you should consider:

- Has your family composition changed (i.e., death, birth, adoption, marriage, divorce)?
- Has there been a significant change in your financial status?
- Does your current estate plan distribute assets based on a formula tied to the estate tax exemption? With the doubling of the previous federal estate tax exemption, you may want your plan reviewed to make sure it continues to match your intentions.
- Are your Living Wills and Powers of Attorney up to date? These documents may become "stale" if not updated every few years.
- Have any children of yours reached the age of 18?
- Have you moved recently?

As always, we welcome the opportunity to discuss your planning needs. All of us here at Wiggin and Dana wish you and your loved ones the very best holiday season and a wonderful 2019.