INSIGHT ON ESTATE PLANNING

Charitable giving in a post-TCJA world
What you need to know in the wake of the new tax law

Understanding the contents of a will

Should a tax apportionment clause be in your estate plan?

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Charitable giving in a post-TCJA world

What you need to know in the wake of the new tax law

The Tax Cuts and Jobs Act (TCJA) represents the biggest overhaul of the tax code in more than three decades. Tax experts are still sorting out all the intricacies. But this much is clear: The TCJA will have a significant impact on estate planning and related aspects, such as charitable giving.

Even though the TCJA reduces tax incentives for making charitable donations for some people, it encourages contributions for others. Let's take a closer look at the new tax landscape and how it relates to charitable giving.

Key provisions

Several tax law changes affecting charitable donations are intertwined with other provisions. The TCJA effectively doubles the standard deduction to $12,000 for single filers ($24,000 for joint filers) and scales back or eliminates some itemized deductions. For instance, the deduction for state taxes is limited to $10,000 annually, while the deduction for miscellaneous expenses is repealed. At the same time, individual tax rates are reduced. These changes are now in effect and scheduled to "sunset" after 2025.

Notably, the tax deduction for charitable donations is preserved. In fact, for 2018 through 2025, the annual deduction limit for cash contributions has increased from 50% of adjusted gross income (AGI) to 60% of AGI. Nevertheless, the confluence of other provisions, especially the doubling of the standard deduction, may discourage charitable intentions. Some individuals who no longer itemize deductions might forgo charitable contributions they would otherwise make. (You must itemize to claim them. However, please note that legislation has been introduced in Congress that would allow taxpayers to deduct contributions even if they don't itemize deductions. The proposed law would also eliminate the current caps on charitable contribution deductions. Please contact your tax advisor for information about the proposal and its current status.)

Another significant change is the increased amount of the gift and estate tax exemption from $5 million to $10 million (inflation-indexed to $11.18 million in 2018). As a result of this increase, fewer individuals will have federal estate tax concerns and thus may be more inclined to use the estate tax savings to make charitable donations, subject to the restrictions stated above. A caveat: State estate taxes may apply at lower limits than the federal exemption.

Charitable techniques to consider

In this new environment, you may use one or more charitable gift techniques as part of a comprehensive estate plan. There are several potential options to consider, including:

Bunching deductions. In the wake of the TCJA, you may claim the standard deduction in some years, so charitable donations won't provide any tax benefit. Conversely, in other years when you itemize, those deductions are valuable. Accordingly, you might bunch charitable gifts in years you expect to itemize and skip large contributions in other years.

Charitable remainder trust (CRT). This trust type remains a viable option under the TCJA. Essentially, you create a trust, funded with property such as real estate or securities, to pay out income to a designated beneficiary for life or for a term of years. The CRT generates a current tax deduction based on government tables. At the end of the trust term, the remainder goes to the charity of your choice.

Donor-advised funds (DAFs). With a DAF, you can exert more control over your charitable endeavors. First, you contribute to a fund, typically managed by a financial institution or another sponsoring organization. Next, you instruct the fund as to how to dole out the money to your favorite charities. Subsequent DAF contributions may be made in years you itemize.

Gifts of property. Instead of giving cash to charities, individuals will frequently contribute appreciated property, such as securities. If the property would have produced long-term capital gains had it been sold instead of donated, the fair market value for deduction purposes is the current value, not the initial cost. This enables the donor to claim a sizable deduction and avoid tax on the appreciation in value.

Several tax law changes affecting charitable donations are intertwined with other provisions.

Charitable rollovers. Under a special tax law provision, an individual age 70½ or older can transfer up to $100,000 directly from an IRA to a charity without any tax consequences. The distribution is neither tax-deductible by the donor nor taxable to him or her, but can satisfy required minimum distribution (RMD) obligations. This technique wasn't affected by the TCJA.

Charitable bequests. You can incorporate charitable gift giving into your estate plan though various bequests, establishing what is important to your legacy. This may be accomplished through various means, such as leaving a specific dollar amount or percentage of assets to charities or naming an organization as the full or partial beneficiary of a life insurance policy or other account.

Review your plan

Charitable gift giving may be a critical component of your estate plan. Take appropriate action based on the impact of the TCJA on your specific situation. Contact your estate planning advisor with any questions. •

Understanding the contents of a will

You probably don't have to be told about the need for a will. It's been said over and over again. But do you know what provisions should be included and what's best to leave out? The answers to those questions may not be as obvious.

Basic provisions

Typically, a will begins with an introductory clause, identifying yourself along with where you reside (city, state, county, etc.). It should also state that this is your official will and replaces any previous wills.

After the introductory clause, a will generally explains how your debts and funeral expenses are to be paid. In the past, funeral expenses were often paid out of the share of assets going to your children, instead of the amount passing to your spouse under the unlimited marital deduction. However, now that the inflation-adjusted federal gift and estate tax exemption has increased to $11.18 million for 2018, this may not be as critical as before. The provisions for repaying debt generally reflect applicable state laws. Consult with your estate planning advisor or attorney concerning your options.

Don't include specific instructions for funeral arrangements. It's likely that your will won't be accessed in time. Spell out your wishes in a letter of instructions, which is an informal letter to your family.

A will may also be used to name a guardian for minor children. To be on the safe side, name a backup in case your initial choice is unable or unwilling to serve as guardian or predeceases you.

Addressing estate taxes

The next section of the will may address estate taxes. Remember that this isn't necessarily limited to federal estate tax; it can also apply to state death taxes. You might arrange to have any estate taxes paid out of the residuary estate that remains after assets have been allocated to your spouse.

Furthermore, if you're using a testamentary trust, it may be required to pay any resulting estate taxes. Coordinate this with other aspects of your will. You can't anticipate every possible scenario, so rely on your advisor or attorney for guidance.

Specific bequests

One of the major sections of your will — and the one that usually requires the most introspection — divides up your remaining assets. Outside of your residuary estate, you'll likely want to make specific bequests of tangible personal property to designated beneficiaries. For example, you might leave a family heirloom to a favorite niece or nephew.

When making bequests, be as specific as possible. Don't simply refer to jewelry or other items without describing them in detail, especially if you own multiple rings or watches or the like. This can avoid potential conflicts after you're gone.

If you're using a trust to transfer property, make sure you identify the property that remains outside the trust, such as furniture and electronic devices. Typically, these items won't be suitable for inclusion in a trust.

If your estate includes real estate, include detailed information about the property and identify the specific beneficiaries. Conversely, if you own property jointly with rights of survivorship, the real estate passes automatically to the surviving owner.

When a common disaster strikes

If you're married, your and your spouse's wills should complement each other. Frequently, an attorney will advise each spouse to insert a "common disaster clause" in the respective wills.

As the name implies, a common disaster clause addresses situations where the spouses die almost simultaneously in a common disaster. This addresses issues about the sequence of death to establish where assets are transferred first. It's especially important in second marriages where each spouse has children from a prior marriage. Without such a clause, the wills may trigger unintended results.

A common disaster clause can also provide protection in situations where property is bequeathed to another beneficiary — say, a child or sibling — and both the person making the will and the beneficiary die within a short time of each other.

Once you've covered real estate and other tangible property, you can move on to intangible property, such as cash and securities. Again, you may handle these items through specific bequests where you describe the property the best you can. Include cash in your home or other places, such as a safe deposit box.

Don't forget about money you're owed. Assign beneficiaries for items that don't fit neatly into any other specific bequests.

Finally, most wills contain a residuary clause. As a result, assets that aren't otherwise accounted for go to the named beneficiaries, often adult children, grandchildren or a combination of family members.

Naming an executor

Toward the end of the will, name the executor — usually a relative or professional — who is responsible for administering it. Of course, this should be a reputable person whom you trust. Also, include a successor executor if the first choice is unable to perform these duties. Frequently, a professional is used in this backup capacity.

Be sure to meet all the legal obligations for a valid will in the applicable state and keep it up to date. Sign the will, putting your initials on each page, with your signature attested to by witnesses. Include the addresses of the witnesses in case they ever need to be located. Don't use beneficiaries as witnesses. This could lead to potential conflicts of interest.

Turn to the professionals

Regardless of your age, health and net worth, if you want to have a say in what happens to your children and your wealth after you're gone, you need a will. Contact your estate planning advisor or attorney to help you draft yours. •

Should a tax apportionment clause be in your estate plan?

Even though the Tax Cuts and Jobs Act doubled the gift and estate tax exemption to $10 million beginning this year (when indexed annually for inflation, the amount is $11.18 million for 2018), there are many families that still have to contend with significant federal estate tax liability. Plus, there may be taxes levied on your estate by your state. If that's the case with your estate, it's important to consider a tax apportionment clause in your will or revocable trust.

How to apportion estate tax

An apportionment clause specifies how the estate tax burden will be allocated among your beneficiaries. Omission of this clause, or failure to word it carefully, may result in unintended consequences.

There are many ways to apportion estate taxes. One option is to have all of the taxes paid out of assets passing through your will. Beneficiaries receiving assets outside your will — such as IRAs, retirement plans or life insurance proceeds — won't bear any of the estate tax burden. Another option is to allocate taxes among all beneficiaries, including those who receive assets outside your will. Yet another is to provide for the tax to be paid from your residuary estate — that is, the portion of your estate that remains after all specific gifts or bequests have been made and all expenses and liabilities have been paid.

There's no one right way, but it's important to understand how an apportionment clause operates to ensure that your wealth is distributed in the manner you intend. Suppose, for example, that your will leaves real estate valued at $5 million to your son, with your residuary estate — consisting of $5 million in stock and other liquid assets — passing to your daughter. Your intent is to treat your children equally, but your will's apportionment clause provides for estate taxes to be paid out of the residuary estate. Thus, the entire estate tax burden — including taxes attributable to the real estate — will be borne by your daughter.

One way to avoid this result is to apportion the taxes to both your son and daughter. But that approach could cause problems for your son, who may lack the funds to pay the tax without selling the property. To avoid this situation while treating your children equally, you might apportion the taxes to your residuary estate but provide life insurance to cover your daughter's tax liability.

Without a clause, state law rules

What if your will doesn't have an apportionment clause? In that case, apportionment will primarily be governed by applicable state law (although federal law covers certain situations). Most states have some form of an "equitable apportionment" scheme.

Essentially, this approach requires each beneficiary to pay the estate tax generated by the assets he or she receives. Some states provide for equitable apportionment among all beneficiaries while others limit it to assets that pass through the will or to the residuary estate.

Often, state apportionment laws produce satisfactory results, but in some cases they may be inconsistent with your wishes.

Talk to your advisor

If estate tax liability remains a concern, consult with your estate planning advisor about the need to address tax apportionment in your estate plan. Without including an apportionment clause, heirs may be burdened with paying the tax attributable to assets they don't receive. •

ESTATE PLANNING PITFALL

You're not paying enough attention to state estate tax laws

The Tax Cuts and Jobs Act (TCJA) provides greater flexibility in estate planning for many taxpayers. Under the TCJA, the federal gift and estate tax exemption is increased from $5 million to $10 million, subject to inflation indexing. The indexed amount for 2018 is $11.18 million.

The exemption is effectively doubled to $22.36 million for a married couple. Thanks to the portability provision, the estate of a surviving spouse can use the unused portion of the exemption from the estate of the first spouse to die.

So, no more estate tax worries for most people, right? Not so fast. For residents of some states, state estate or inheritance taxes can still present a significant problem.

Currently, 12 states and Washington, D.C., impose an estate tax, while six have an inheritance tax. Maryland is the only state with both. Of those states with estate taxes, Washington maintains the highest rate at 20%, while Nebraska has the loftiest inheritance tax rate at 18%. Generally, the state estate tax exemptions on the books are lower than the federal exemption of $11.18 million.

In recent years, several states have moved away from taxing the estates of their residents, including New Jersey, which completed the phaseout of its estate tax repeal in 2018 (although it retained its inheritance tax). Keep in mind that the trend could reverse quickly, as states search for ways to make up revenue shortfalls in the wake of the TCJA.

Lesson to be learned: Don't assume you're completely in the clear on estate taxes.

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Five Things to Consider When Making Educational Gifts to Students

The gift of higher education is one of the most satisfying contributions that a person can provide to a loved one. While some gifts are planned years in advance (e.g., gifts to 529 plans or educational trusts), there are times when gifting to a student who is currently in college can help create a path to success that otherwise would not be possible. When planning such a gift, the following considerations are important to keep in mind:

1. Direct payments of tuition are gift-tax free. Tuition payments made directly to qualified institutions, including colleges and universities, are gift-tax free, no matter the payment size. This special treatment for tuition payments is not available for any other education-related expense. To qualify for this treatment, the check must be written by the donor directly to the institution. The funds cannot pass through the student or a trust.

2. Gifts for non-tuition needs can be made with annual exclusion gifts. If you wish to make gifts in excess of tuition, or solely for non-tuition needs, the annual exclusion amounts can be used. Under current law, an amount of $15,000 per recipient ($30,000 per recipient if you are a married couple) may be transferred to a recipient each year using the "annual exclusion," and such amounts will not be subject to the gift tax. The annual exclusion amounts change periodically.

3. Gift tax returns are the donor's responsibility. For any year in which a gift is made, a gift tax return may need to be filed. Generally, a gift tax return must be filed if annual exclusion amounts are exceeded, if annual exclusion gifts are "split" with a spouse, if gifts are made to a trust, if gifts are made of discounted or hard-to-value assets, or if gifts trigger the generation-skipping-transfer tax reporting requirements. Even if a return is required, under current law you will not owe gift tax unless you have gifted more than your lifetime exemption amount of $11.18 million ($22.36 million per married couple), not including annual exclusion gifts. Note that like the annual exclusion amount, these exemption amounts change periodically.

4. Recipients will owe no income tax on the gifts. A true gift is not treated as income to the recipient for state or federal income tax purposes. If the gift is of appreciated property, the recipient will owe tax on the capital gains when the property is later sold.

5. Gifts may jeopardize financial aid. If your student needs or is receiving financial aid, proceed with caution in making gifts while the student is in school. Gifts made outright or of tuition will be treated as "untaxed income" for purposes of the Free Application for Federal Student Aid (FAFSA) and can affect eligibility for aid in the next school year. Better options may be to contribute to a 529 plan if one has already been set up for the student (which may have more favorable financial aid treatment), to help pay off a student loan after the student graduates, or to explore other workarounds with the help of a competent advisor.

If you are considering making a gift to benefit a loved one in college, it is important to structure the gift in a manner that is tax-efficient and works for the student, too. If you have any questions about gifts, please contact a member of the Stokes Lawrence Estate Planning Group at (206) 626-6000 in Seattle or (509) 853-3000 in Yakima.