Wealth Transfer: Full Steam Ahead

By Chris Zander

A lot has happened since Donald Trump was elected the 45th president of the United States. But here's one thing that hasn't happened: the widely anticipated spike in inflation and interest rates, both of which are still hovering at record lows, while the stock market reaches record highs. Even as we wait to see how the proposals announced in late September pan out, families considering wealth transfer and other tax-planning strategies have little reason to hesitate in this market environment.

Sure, it's possible that the estate tax exemption, currently set at $5.49 million per individual, will be entirely abolished in the first big tax reform since 2013, although President Trump will almost certainly encounter considerable opposition on this score. As a result, we caution against implementing any strategies that incur a gift tax until the dust has settled on tax legislation. If the estate tax is fully repealed, then transfers at death would incur no estate tax and a premature gift tax payment would be unfortunate. However, wealth transfer strategies designed in the context of a family's overall strategic plan still make sense.

For example, gifts that properly utilize the individual $14,000 annual gift tax exclusion, or gifts made up to the individual's remaining federal gift tax exemption, also $5.49 million, should not result in gift taxes. Also, the unlimited exclusion for payments made directly to medical or educational institutions – such as college tuition payments – continues to be an effective wealth transfer technique, especially for those who have a large number of family members or friends that they would like to help.

Wealth transfer strategies that are structured to remove only the future appreciation on assets from family estates also shouldn't be a source of regret if the estate tax is repealed – and could save families a great deal if it's not (or in the event of a partial repeal or later reinstatement). These include so-called freeze transactions such as grantor retained annuity trusts, or GRATs, sales to intentionally defective grantor trusts, and intra-family loans. Each of these benefits significantly from lower interest rates, which reduce the hurdle for success. A GRAT established in October 2017, for example, will have a hurdle rate of only 2.2% annually over the course of its prescribed term. Examples of assets used in these types of strategies include equity

$5.49 MILLION

Individual Federal Gift Tax Exemption

in undervalued closely held businesses or late-stage venture capital investments, a rental real estate property in a promising part of the country, or a single public stock position in a sector that is out of favor at the moment but holds potential for growth over the next few years.

> *Wealth transfer strategies could save families a great deal*

Concerns have ebbed that transfers relating to closely held business and other non-marketable assets would be adversely affected by proposals under section 2704 of the Internal Revenue Code. Treasury Secretary Steven Mnuchin recently called the 2016 proposals "unworkable" and recommended withdrawal.

It's also worth noting that there has been no mention to date in the latest tax proposal of the loss of a step-up in basis. In previous proposals, the repeal of the estate tax was coupled with a repeal of the tax basis step-up under IRC.1014, which would result in an income tax due at some point on the appreciation of assets (the step-up in basis provision eliminated that tax at death). While one previous proposal imposed this tax at death (with an exclusion amount), others allowed for a deferral of tax until the asset was ultimately sold.

One idea to combat this potential issue of an income tax at death is the use of a charitable remainder unitrust, or CRUT, for individuals who have highly appreciated stock or other assets in their estate. Since these assets may not receive a step-up in basis (and potentially incur an immediate income tax at death), contributing them to a CRUT could be utilized to create a tax-efficient, long-term income stream to the individual while offering portfolio diversification and a benefit to charity in future years. The viability of this strategy increases if the step-up in basis is repealed.

In the interim, families have reason to wonder why they still need trusts if the estate tax could be repealed. Quite apart from the possibility that it won't be fully or permanently repealed, trusts enable families to provide governance and protection around their assets for generations. Without a crystal ball, grantors and/or decedents will still want trusts to carry out their intentions under myriad economic and tax scenarios, and as family circumstances evolve and individuals live longer. It's as least as important as it ever was to establish trusts with flexible terms, in situses that offer the ability to decant a trust or otherwise modify it to allow trustees and trust protectors to address future legislation and other changes.

> *We caution against implementing any strategies that incur a gift tax*

The proposed tax reform also simplifies the individual tax code, a mixed blessing for many affluent families. The pros include a drop in the headline tax rates for high earners (and the sole proprietors of pass-through businesses), the repeal of the Alternative Minimum Tax, or AMT, and the retention of both the mortgage interest and charitable deduction. There is at least one very significant con; in that property owners in high tax states and towns will lose some of their most meaningful itemized deductions related to state and local income taxes, as well as property taxes. To the extent that tax rates are slated to drop next year (and if any tax reform is not retroactive), it makes sense to consider a larger charitable gift in 2017 to maximize the current value of the tax deduction.

> *It makes sense to consider a larger charitable gift in 2017*

Certainly, income tax planning will remain important for individuals and families, to maximize annual charitable deductions and to avoid or defer capital gains taxes (neither of which are yet impacted by the proposed reforms). As we wrote in the immediate aftermath of the 2016 election, long-term tax deferral and compounding, while eventually taxed, still drives long-term asset growth, even if current tax rates are low. Decisions made now, as we approach year-end planning and look forward to 2018, could have lasting repercussions. (See the end-of-year planning article on page 15.)

At Evercore Wealth Management and Evercore Trust Company, it's our job to make sure that our clients know what to expect, as much as anyone can in this political environment, and are on course to meet their goals.

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Making a List: Year-end Gift & Wealth Transfer Planning

Editor's note: Evercore Wealth Management advisors work directly with families and their other trusted advisors to prepare for year-end. This is an extract from a comprehensive framework for those discussions sent to clients in early October. For further information, see Chris Zander's article on page 12 and contact a Wealth & Fiduciary Advisor regarding your family's specific circumstances.

☐ GIFTS AND WEALTH TRANSFER

The lifetime federal gift, estate and generation-skipping tax exemption increased to $5,490,000 in 2017 from $5,450,000 per individual. This allows individuals who have utilized all of their exemption in 2016 to make a gift of an additional $40,000, exempt from federal estate, gift, and generation-skipping tax.

Annual exclusion gifts allow individuals to give up to $14,000 per year to anyone without gift tax (married couples may give up to $28,000). Checks to individuals must be cashed prior to December 31. Parents or grandparents may also want to consider additional tax-free gifts in the form of direct payments for health insurance premiums, medical expenses, or school tuition. These payments must be made directly to the applicable institution to qualify for this unlimited exclusion.

As we wait for the dust to settle on tax reform, we are not recommending making any taxable gifts. Instead, we suggest focusing on exemptions, exclusions, and other gifting techniques that do not incur gift taxes, to transfer wealth to heirs.

☐ CHARITABLE GIVING

Given current income tax rates and stock market levels, individuals should consider charitable contributions using qualified appreciated stock. For shares held for more than one year, the current fair market value of the securities contributed can be deducted (subject to certain AGI limitations), avoiding the capital gains tax due on the appreciation had the asset been sold.

Those with longer-term philanthropic objectives, who would also benefit from a larger charitable deduction in 2017, may want to consider establishing a private foundation or donor-advised fund. These vehicles can achieve current income tax-planning objectives, while deferring decisions on which charities will receive the funds. Charitable remainder trusts may also be a solution for those who would like to diversify an appreciated stock position, receive a charitable income tax deduction, and retain a tax-efficient income stream for life while providing for a charity upon their death.

☐ IRA DISTRIBUTIONS

IRA account owners over age 70 ½ can make tax-free direct transfers (up to $100,000 in the calendar year) from IRA accounts to charity to satisfy their required minimum distribution, or RMD. With this strategy, the charitable portion of the RMD is excluded from ordinary income tax but is not tax deductible. IRA owners who turn age 70½ during 2017 have until April 1, 2018 to take their first required minimum distribution and must take the second by December 31, 2018. It may make sense to wait until April in the event that the ordinary income tax rate will be reduced in any potential tax reform. IRA account owners already in distribution mode must take their annual RMD by December 31, 2017.

☐ EDUCATIONAL PLANNING

529 College Savings Plans may be an effective strategy for setting aside funds for college expenses for children, grandchildren, or other potential beneficiaries. 529 Plans have contribution limits set by individual states, and the federal gift tax rules apply to contributions. Contributions are not deductible for federal income-tax purposes, although they may be deductible for state income tax purposes. Distributions used to pay qualified tuition expenses (expanded to include computers, computer technology and Internet services) are tax-free.

By filing a gift tax return, giving can be accelerated by using the annual exclusion gifts for the next five years, and making up to a $70,000 contribution for an individual (or a joint $140,000 contribution with a spouse). The owner of the 529 Plan may also change beneficiaries or withdraw assets, subject to a penalty, in the future, should circumstances change.