

# Planning under the New Tax Rules



## PLANNING UNDER THE NEW TAX RULES

Businesses, both large and small, as well as individuals, face a markedly different tax landscape following passage of the Tax Cuts and Jobs Act of 2017. Tax brackets have been lowered, deductions have been pared back and, for individuals, a larger standard deduction means that only about 5% of taxpayers each year will itemize. Changes to gift and estate taxes – now sheltering up to \$11.18 million – will affect how assets are transferred from one generation to the next and to charity. The recent tax legislation makes now a good time for people to review their estate plans and ask:

- Will I be able to keep more of what I earn each year?
- Do I still have to worry about federal estate taxes?
- What will happen after the new rules sunset at the end of 2025?
- Are there other taxes that will affect my family after my death?

- How can I best distribute assets to leave my family secure?
- Is it possible for my estate plan to leave the world a better place?

## INCOME TAXES

The Tax Cuts and Jobs Act ushered in lower rates for individuals, beginning in 2018 and running through 2025.

Single Individuals		
Column 1	Tax on Column 1	Rate on Excess
Taxable Income		
\$ 0	\$ 0	10%
9,525	952.50	12
38,700	4,453.50	22
82,500	14,089.50	24
157,500	32,089.50	32
200,000	45,689.50	35
500,000	150,689.50	37



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### Joint Returns and Surviving Spouses

Column 1 Taxable Income	Tax on Column 1	Rate on Excess
\$ 0	\$ 0	10%
19,050	1,905	12
77,400	8,907	22
165,000	28,179	24
315,000	64,179	32
400,000	91,379	35
600,000	161,379	37

Taxpayers who are still working should review their withholding early in 2018 to determine if they can have less withheld from each paycheck. The same is true for those who make quarterly estimated tax payments. Taxpayers are required to pay at least 90% of the taxes they owe each year, through withholding or estimated payments, to avoid a penalty.<sup>1</sup> Those who overpay are entitled to a refund when they file their returns in April of the following year, but in the meantime, have given the IRS an interest-free loan. It's better, from a tax perspective, to pay in only the minimum due each year.

### Capital Gains Tax

Capital gains rates on the sale of appreciated assets remain the same.

Tax bracket	Tax rate
10%, 12%	0%
22%, 24%, 32% and 35%	15%
37%	20%

In addition, a 3.8% tax is imposed on net-investment income (dividends, capital gains, rents, royalties, nonqualified annuities, income from businesses that are passive activities and income from trading financial instruments and commodities). The tax applies to taxpayers with adjusted gross income in excess of \$200,000 (single filers and heads of households) or \$250,000 (joint filers).

### Standard Deductions

A near doubling of the standard deductions means only about 5% of all taxpayers will itemize, compared to about 30% under old tax laws.

Single taxpayers	\$12,000
Heads of households	18,000
Joint filers/surviving spouses	24,000

Single taxpayers and heads of households are entitled to additional deductions of \$1,600 if blind or age 65; for joint filers, the additional deductions are \$1,300.



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### Itemized Deductions

Several deductions have been reduced or eliminated, also contributing to the decrease in the number of taxpayers itemizing their expenses. With the exception of the increase in the deduction limit for cash gifts to charity, these changes to itemized deductions apply only through 2025.

- Home mortgage interest<sup>2</sup> – Taxpayers can deduct the interest on home mortgages for a first and second house, on indebtedness up to \$750,000. Interest on mortgages entered into prior to December 15, 2017, continues to be deductible on up to \$1 million of indebtedness. The interest on home equity loans is deductible only if the loan is used to buy, build or substantially improve the home securing the loan.

- Medical expenses – Through 2018, taxpayers can claim a deduction for medical expenses that exceed 7.5% of adjusted gross income.<sup>3</sup> In 2019, the threshold increases to 10% of adjusted gross income.

- State and local taxes – A deduction is available for state and local income tax or sales tax and real estate taxes, up to a maximum of \$10,000.<sup>4</sup>

- Charitable deductions – Cash gifts to charity are now deductible up to 60% of adjusted gross income (previously 50%). For gifts of appreciated assets, the limit remains at 30% of adjusted gross income. For example, Joanne, who has adjusted



gross income of \$50,000 and makes a cash gift of \$30,000, can deduct the entire \$30,000 in the year of the gift. Paul, also with adjusted gross income of \$50,000, contributes appreciated stock held more than one year that is now worth \$20,000. He can deduct up to \$15,000 in the year of the gift. Excess contributions can be carried over and deducted for up to five additional years.

- Casualty losses – Losses not reimbursed by insurance are deductible only if the loss was attributable to a disaster declared by the President.<sup>5</sup> Deductions are subject to a \$100 minimum loss and a threshold of 10% of adjusted gross income.

- Miscellaneous itemized deductions<sup>6</sup> – Expenses such as safe deposit rental fees, tax return preparation fees, subscriptions to professional publications, union dues and investments fees are no longer deductible. This includes fees for appraisals in connection with gifts to charity.



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### Other Deductions

■ Moving expenses – Through 2025, the above-the-line deduction allowed for work-related moving expenses is suspended, except for members of the Armed Forces.<sup>7</sup>

■ Alimony – The above-the-line deduction previously allowed for alimony or separate maintenance payments made pursuant to a divorce or separation agreement is no longer available to the paying spouse.<sup>8</sup> This applies to divorce or separation instruments entered into after 2018.

### Alternative Minimum Tax

The corporate alternative minimum tax has been repealed. The alternative minimum tax continues for individuals, but with increased exemption amounts of \$109,400 for couples and \$70,300 for all other filers. Alternative minimum tax rates – 26% and 28% – are lower than some regular tax rates, but apply to a wider base of income. Taxpayers must calculate both the regular and the alternative minimum tax and pay the higher of the two. Charitable gifts remain deductible under both the regular and the alternative minimum tax.

### CORPORATE TAXES

The tax on corporate income is now a flat 21%. Owners of pass-through entities (partnerships, LLCs, S corporations and

sole proprietorships) can claim a 20% deduction on the first \$157,500 (single taxpayers) or \$315,000 (married taxpayers) of income.

### CHARITABLE GIVING UNDER HIGHER STANDARD DEDUCTIONS

It's estimated that about 80% of Americans give to charity each year, but under prior laws, only about 30% of taxpayers itemized their deductions. The rest received no additional tax benefit from their generosity. With higher standard deductions and restrictions on itemized expenses, only about 5% of taxpayers will itemize.

Example: Karen and Jeff, both age 68, have a standard deduction of \$26,600 (\$24,000 + \$2,600 in additional deductions for both being over age 65). They paid off their mortgage many years ago, so their only itemized deductions are the \$10,000 allowed for state and local taxes and the \$10,000 they contribute to charities each year – far short of their \$26,600 standard deduction.

What are some options for Karen and Jeff to boost their deductions?

■ They could bunch several years' worth of gifts. By making both their 2018 and 2019 gifts in 2018, the \$20,000 in charitable contributions, plus the \$10,000 in state and local taxes, allows them to itemize in 2018.



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They could use appreciated securities to make their gifts, thereby avoiding the capital gains tax that they would owe if they sold the shares, for added tax savings.

■ The couple could establish a charitable remainder unitrust. They could make a larger gift – one that generates a deduction sufficient to exceed the standard deduction – from which they would retain income for their joint lives. Funding their trust with appreciated stock provides additional tax savings. When the shares are sold by the trustee, there is no loss to capital gains tax. Karen and Jeff receive payments based on the full value of the stock. A trust funded with \$50,000 that pays the couple 5% of the annual value of the trust assets (\$2,500 the first year) would generate a charitable deduction of slightly more than \$19,000.<sup>9</sup> When combined with their \$10,000 state and local taxes, they can itemize their deductions. Most satisfying for Karen and Jeff is knowing that when the trust ends, the trust will result in a significant gift to their favorite charity. They can add to their trust in future years, generating additional deductions and increased annual payments. The following tables show examples of deductions at various ages and payout rates, for both one-life and two-life charitable remainder unitrusts.

### Deduction for Gift of \$100,000 to Unitrust for Life of One Beneficiary

Age of Beneficiary	5% Annual Payout	6% Annual Payout	7% Annual Payout
60	\$38,186	\$32,281	\$27,519
65	44,977	39,053	34,119
70	52,403	46,675	41,756
75	60,212	54,916	50,238
80	67,833	63,154	58,913

### Deduction for Gift of \$100,000 to Unitrust for Lives of Two Beneficiaries

Ages of Beneficiaries	5% Annual Payout	6% Annual Payout	7% Annual Payout
60/60	\$27,520	\$21,526	\$16,918
65/65	33,853	27,544	22,497
70/70	41,169	34,763	29,441
75/75	49,294	43,066	37,708
80/80	57,755	51,985	46,862

■ The couple could establish a charitable gift annuity\*. The recommended gift annuity rate for their ages is 4.4%. If they contribute \$75,000, they will be entitled to

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a charitable deduction of slightly more than \$24,000.<sup>10</sup> Plus, they will receive annuity payments of \$3,300 per year, a large part of which would be tax-free for their joint life expectancies if the gift annuity is funded with cash. If they use appreciated stock to fund the gift annuity, the tax-free portion will be less, but they will avoid some capital gains tax and pay the balance over their life expectancies. The chart on the right shows examples of single-life gift annuity rates (two-life rates are slightly lower). The table below shows the tax benefits of a \$50,000 one-life charitable gift annuity at various ages.

### Examples of Single-Life Gift Annuity Rates

Age of Recipient	Payout Rate	Age of Recipient	Payout Rate
60	4.4%	76	6.0%
62	4.5	78	6.4
64	4.6	80	6.8
66	4.8	82	7.2
68	4.9	84	7.6
70	5.1	86	8.0
72	5.4	88	8.4
74	5.7	90 or over	9.0

Another option, not yet available to Karen and Jeff, is to make qualified charitable distributions (QCDs) from their

### Benefits of a Charitable Gift Annuity for \$50,000\*

Age	Recipient's Annual Payment	Tax-Free Portion	Taxable Income	Charitable Deduction	Effective Payout Rate**
60	\$2,200	\$1,439	\$761	\$15,317	5.7%
65	2,350	1,605	745	18,067	6.3
70	2,550	1,826	724	20,973	7.0
75	2,900	2,158	742	23,252	8.1
80	3,400	2,618	782	25,376	9.6
85	3,900	3,163	737	28,490	11.3
90	4,500	3,753	747	31,600	13.4

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\*\* The "effective" rate takes into account the donor's charitable deduction tax savings and the benefits of the tax-free income in a 24% federal income tax bracket. Deductions vary according to current interest rates.



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IRAs. Once they reach age 70½, they can each begin making tax-free gifts to charity from their IRAs of up to \$100,000 annually.<sup>11</sup>

Peter and Becky, ages 74 and 73, contribute \$5,000 annually to their favorite charities. In 2018, they will have to take required minimum distributions from their IRAs totaling \$45,000. In their 22% income tax bracket, they will pay tax of \$9,900 on these distributions. The couple won't be able to itemize their deductions in 2018, but if they direct the custodian of their IRAs to send \$5,000 directly to the charities, they will save taxes even without a deduction. The gift to charity can

take the place of part of their required minimum distribution, saving them \$1,100 in income tax that they would otherwise owe.

### GIFT AND ESTATE TAXES

Gift, estate and generation-skipping transfer taxes will no longer be a concern to most Americans after a doubling of the credits. Gifts and estates up to \$11.18 million will be completely sheltered from tax through 2025, with annual adjustments for inflation. Couples will be able to shelter estates up to \$22.36 million. According to IRS figures for estate tax returns filed in

### IRA Gift Rules

- ❑ Donors must be age 70½ or older and own a traditional or Roth IRA. Other retirement plans, such as pensions, 401(k) plans and others are not eligible.
- ❑ Only the IRA trustee can transfer gift amounts to a qualified organization. If IRA owners withdraw funds and then contribute them to charity separately, amounts withdrawn will be included in the donor's gross income.
- ❑ No charitable deductions are allowed, but gift amounts will not be included in the donors' incomes.
- ❑ IRA gifts may not exceed \$100,000 per account owner. The ceilings on regular charitable contribution deductions (60% of adjusted gross income for cash, 30% of AGI for capital gain assets) do not apply to IRA gifts.
- ❑ IRA gifts cannot be made to charitable remainder trusts or other life income gift arrangements.
- ❑ To make an IRA gift, just contact the custodian or trustee of your account. Please call our office, as well, so we may ensure proper transfer and acknowledgement of your thoughtful contribution.
- ❑ If you choose to make a gift to Queen's University from your IRA account, please direct it to the US Foundation for Queen's University at Kingston. Our US Foundation is a 501 (c)(3) tax-exempt organization recognized under the U.S. Internal Revenue Code.



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2016 (covering deaths in parts of 2015 and 2016), 12,411 returns were filed. Of those, only 4,142 were for gross estates of \$10 million or more. After 2025, the amount sheltered from gift, estate and generation-skipping transfers will revert to \$5 million, with inflation adjustments that have occurred since 2011.

ing continuing resources for the charities they supported during their lifetimes. Including a gift to charity in an estate plan may not be needed to save on taxes, but for many people, it's simply the right thing to do. Charitable estate gifts may also address other planning goals.

### *Charitable remainder trusts*

Charitable remainder trusts not only enable donors to save income taxes by boosting itemized deductions; they can be an excellent way to substitute for a gift in a will or living trust. You can choose a trust that pays a fixed amount annually (annuity trust) that is at least 5% of the value of assets contributed to the trust, or a trust that pays a fluctuating amount (unitrust) that is at least 5% of the value of trust assets as determined annually.<sup>12</sup> In either case, you'll be entitled to an income tax charitable deduction and payments for life. When the trust ends, the remaining assets pass to charity, just as if you had included a gift in a will.

Example: Ralph knows his \$3 million estate is sheltered from estate tax, but he is interested in providing a significant gift for a favorite charity. While he could simply include a gift in his will or living trust, Ralph has instead decided to use \$250,000 in highly appreciated stock to fund a charitable remainder unitrust. He is, in essence, accelerating his gift and, in



Do the larger credits mean that estate planning is no longer important? Estate planning has always been about much more than estate *tax* planning. It involves, first and foremost, creating a thoughtful plan for the transfer of assets that you have accumulated over a lifetime of work and saving. It means addressing the needs of family members, including those who may have special needs. For many people, estate planning also means provid-



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the process, securing tax savings in the form of an income tax deduction, rather than an estate tax deduction. Because he will receive payments for life from the unitrust, he doesn't really miss the dividends he previously received from the shares of stock.<sup>13</sup>

### *Charitable gift annuities\**

Another way to make a gift today, retain payments for life, and know your gift will eventually benefit charity is to arrange a charitable gift annuity. Similar to the charitable remainder trust, the gift annuity offers income tax deduction savings.

Example: Linda, age 71, wants to create a legacy at the charity where she volunteers. She won't need an estate tax deduction, but if she gives \$100,000 to the charity to fund a gift annuity, the charity will make payments to her of \$5,300 (5.3%) annually for as long as she lives. Her deduction of nearly \$42,000 saves more than \$9,000 in income tax.

### *Remainder interests in homes and farms*

Donors can deed homes or farms to charity while retaining the right to use the property for life.<sup>14</sup> An income tax deduction is available for charity's future right to the property.

Gerald owns farmland that has been in his family for three generations, but his children have all moved away and are not interested in farming the land. Gerald still

owns some himself but rents out the rest. He could make a gift of part or all of the land to charity while keeping the right to farm or retain the rental income from the land. For his gift, Gerald would be entitled to an income tax charitable deduction that would allow him to itemize his deductions. The result would be similar to leaving the land to charity in his will, although with better tax results. If Gerald decides in a few years that he no longer wants the land, he and the charity could jointly sell the acreage, with each entitled to a share of the proceeds.

Accelerating charitable gifts through charitable remainder trusts, charitable gift annuities and gifts of remainder interests in homes and farms offers income tax savings while meeting philanthropic goals. But charitable gifts can also be used in estate plans to achieve other planning purposes, even if estate tax savings are not an issue.

### *Avoiding income tax on retirement assets*

Marlene, who has a \$750,000 IRA, would like the funds to pass to her five nieces and nephews at death, but she knows any distributions will be subject to income tax. She also wants to establish a charitable endowment with a favorite charity. Marlene could leave the IRA to the charity, conditioned on the charity issuing a gift annuity for each niece and nephew, paying a rate equal to the rate paid to other annuitants the same ages as

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the nieces and nephews at the time of her death.<sup>15</sup> If any of the nieces or nephews are younger than the charity's minimum age at Marlene's death, annuity payments could be deferred for a few years, offering higher payout rates to the recipients. Marlene's estate would not need the deduction to which she would be entitled. The real benefit is knowing the nieces and nephews will receive payments for life as a reminder of her love for them, while also providing a substantial benefit to charity. Each niece and nephew would receive payments based on the full \$150,000 of his or her gift annuity, without any depletion from income taxes.

### *Too little for taxes, too much to leave to heirs*

Stuart's estate, at \$4 million, is well below the \$11.18 million sheltered from taxes. He wants most of his estate to pass to his three children, but doesn't feel he needs to leave them everything. He might leave his children what he thinks is appropriate, while leaving the rest to charity. He could direct, for example, that each child is to inherit \$1 million, with the balance after fees and expenses (the residue) passing to charity.

### *Letting heirs mature*

Barbara and Joe have an estate of about \$7 million. They want to leave something for their grandchildren at the death of the survivor, but they're concerned that the

grandchildren may be too young to handle an inheritance responsibly. A charitable lead trust<sup>16</sup> would allow them to satisfy their charitable goals while also providing for their grandchildren. The couple could direct that \$2 million pass to a lead trust at the survivor's death. The lead trust could make payments for a number of years to charity, after which the funds would be distributed to the grandchildren. Barbara and Joe could instead fund the lead trust during their lifetimes, completely sheltered from gift and generation-skipping transfer taxes. The couple would remove the \$2 million from their gross estates, which could save income taxes.

### **FOR MORE INFORMATION**

Major tax law changes are always a reason to review estate plans, and the Tax Cuts and Jobs Act is certainly no exception. We encourage you to take out your will or living trust to see if the documents still reflect your wishes. See your attorney if you want to make any changes to an existing will or have a new will drafted. We would also be pleased to provide more information about the charitable gift ideas discussed in this booklet or to work with you and your advisers to craft a plan that addresses not only your goals for your family, but also for your philanthropy. Please feel to contact our office.



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### **NOTES FOR TAX ADVISERS**

1. Code §6654
2. Code §163(h)
3. Code §213
4. Code §164
5. Code §165
6. Code §§62(a)(1); 67(a); 212(l)
7. Code §§134; 217(a)
8. Under Code §61(a)(8), alimony and separate maintenance payments are included in gross income. The deduction allowed under Code §215(a) is repealed for divorce or separation agreements entered into after 2018.
9. Assumes quarterly payments and the use of a 2.6% §7520 rate.
10. Assumes quarterly payments and the use of a 2.6% §7520 rate.
11. Code §408(d)(8)
12. The payout rate may not exceed 50% of the initial value of the trust assets for annuity trusts or 50% of the annual trust value for unitrusts. Code §§664(d)(1)(D), (d)(2)(D). The value of the charitable remainder must be at least 10% of the net fair market value of the assets transferred on the date of the gift.
13. Gifts to charitable remainder trusts are irrevocable.
14. Code §170(f)(3)(B)(i)
15. Letter Ruling 200230018
16. Code §§170(f); Reg. §§20.2055-2(e)(2)(v)(c), (vi)(c); 25.2522(c)-3(c)(2)(v)(c), (vi)(c)



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### NOTES

*The materials contained in this booklet are intended to show only some of the ways you can benefit our future and minimize your federal tax liability – with examples of anticipated federal tax liability. Thus, you should not take any action without first consulting your attorney.*

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#### \*Residents of the United States

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