

# Client Bulletin

Smart tax, business and planning ideas from your Trusted Business Advisor<sup>SM</sup>

July 2018

## More give in the gift tax



The Tax Cuts and Jobs Act of 2017 increased the federal estate tax exemption to \$11.18 million for 2018. That's per person, so the combined exemption for a married couple can be as much as \$22,360,000 worth of assets this year.

The same ceilings apply to the federal gift tax, which offsets the estate tax.

**Example 1:** Mona McAfee plans to give \$20,000 to her son Luke this year. Does that mean that Mona's estate tax exemption would be reduced to \$11,160,000?

Probably not. In addition to the lifetime exemption numbers now in effect, there is also an annual gift tax exclusion. Due to an ongoing process of inflation adjustment, that exemption increased to \$15,000 in 2018. Therefore, in 2018, each person can give up to \$15,000 to any number of recipients without incurring gift tax consequences. That's up from an annual \$14,000 exclusion, which was in effect the previous five years.

Here, Mona's \$20,000 would be partially covered by the \$15,000 exclusion, so only \$5,000 will have gift tax consequences. Mona would have to report a \$5,000 taxable gift on IRS Form 709. That \$5,000 taxable gift will reduce her current federal estate and gift tax exemption amount to \$11,175,000, assuming no other taxable gifts have been made.

As the recipient of the gift, Luke will pay no taxes.

### Real world relevance

Most people won't have estates close to \$11 million, so this exercise might seem academic. Still, the \$15,000 annual gift tax exclusion can have practical effects in many situations. It's also worth noting that paying someone else's medical or education bills directly won't be included in the \$15,000 allowance.

**Example 2:** Rhonda Cole wants to provide financial support for her son Mark's two children, Ken and Julie. To do so, Rhonda pays tuition bills for Ken and Julie directly to their colleges. The total is \$50,000. In addition, Rhonda gives them each \$15,000 in 2018 and no other gifts.

Rhonda also decides to give Mark \$15,000 this year and pays \$5,000 worth of bills from Mark's medical procedures directly to the health care providers. In total, Rhonda has given \$100,000 to her loved ones, reducing her taxable estate by that amount. However, she hasn't gone over the \$15,000 exclusion for any recipient in 2018, so Rhonda hasn't made any taxable gifts and will not have to file a gift tax return.

## In this issue

- 1 More give in the gift tax
- 2 Don't neglect estate planning
- 3 Moving your business to a low-tax state
- 4 Tax calendar

## Bountiful bequests

The IRS has clarified that the 2018 indexed federal estate tax exemption amount is \$11.18 million, not the original estimate of \$11.2 million.

continued on next page →

## Trusted advice

### Gift tax notes

- The gift tax lifetime exemption ceiling of \$11.18 million for 2018 will increase with inflation, but much lower limits are scheduled after 2025. There is some uncertainty about how this reduction, if it takes effect as scheduled, will affect large taxable gifts.
- Any future reduction in the lifetime gift tax exemption is unlikely to affect gifts that conform to annual gift tax exclusion rules.

Note that the \$15,000 limit presents a handy ceiling for making family gifts each year without the bother and expense of filing a gift tax return. This strategy won't work as well if Rhonda gives Mark \$50,000 so Mark can pay his children's college bills. Then, Rhonda will have made a taxable gift of this amount and will be required to file Form 709.

### Paired planning

Other possibilities exist if a married couple holds assets jointly, perhaps

in a bank or brokerage account. A gift from such an account, or a gift of other property, by one spouse can be considered to be divided equally between the two spouses, so the annual gift tax allowance effectively increases to \$30,000. There are two ways to do this. The easy way would be for each spouse to write a separate check for \$15,000. If this is not practical, the spouses can get the benefit of a \$30,000 annual exclusion by electing "gift splitting" on Form 709.

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## Don't neglect estate planning

The article, "More give in the gift tax," in this issue mentions that the federal estate tax exemption now exceeds \$11 million per person. Accordingly, few individuals or married couples will owe this tax. Nevertheless, there is more to successful wealth transfer than reducing or eliminating estate tax. Ideally, you'll want your assets to pass to the desired recipients with a minimum of turmoil and expense.

To start, you should have a will prepared by an experienced attorney. Your will should not only name specific heirs for specific assets, but also identify an executor who will administer your estate and, if relevant, guardians who will care for any minor children.

Once your will has been prepared, don't file it away and forget about it. Review the document periodically, especially after major life events such as births, deaths, marriages, and divorces.

In addition to a will, other efforts should be included in your estate planning.

### Beneficiary designations

Many assets will pass to a beneficiary or co-beneficiaries at your death. They include retirement accounts, annuities, and life insurance proceeds, as well as certain bank and investment accounts. The good news is that these assets usually pass without having to

go through probate, which might be expensive and time consuming.

The bad news? Generally, a beneficiary designation will override what's in a will. Keeping beneficiary designations current can be vital. Except when a legal agreement is in place, you probably won't want assets to pass to an ex-spouse under an old beneficiary form.

Employer-sponsored defined contribution retirement plans, such as 401(k)s, may be required to pass to a surviving spouse, unless a waiver has been signed. Complying with such rules may save your heirs from an unhappy ending.

### Revocable trusts

In recent years, revocable trusts (also known as living trusts) have become popular. As the name indicates, these trusts can be undone, with trust assets reverting to the trust creator, known as the grantor. Meanwhile, the creator continues to control the assets in the trust and have access to income from such assets.

Assets transferred into such trusts can avoid going through probate at the creator's death. As mentioned previously, retirement plans and other assets avoid probate anyway. The same is true for assets held as joint

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## Did you know?

Recognizing tax burdens, the U.S. areas with the highest cost of living are Manhattan, San Francisco, Silicon Valley, and Brooklyn, in that order. Among 253 locations studied, total taxes as a percentage of gross income range from 25% (Casper, WY) to 45% (Manhattan, NY). In lower cost areas such as Memphis, Oklahoma City, and Cincinnati, gross income under \$75,000 could provide a standard of living requiring over \$300,000 in Manhattan and more than \$200,000 in San Francisco.

Source: Wahrheit Ventures

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tenants with right of survivorship—such property passes to the surviving owners.

Therefore, probate avoidance applies to other types of assets if they are held in a revocable trust. To get this benefit, assets must be transferred into the trust.

Beyond probate avoidance, revocable trusts also might reduce administrative expenses by helping the trustee to identify and gain control over the assets. Additionally, a revocable trust can be valuable in case of incapacity. Control of trust assets may pass to a successor trustee or co-trustee.

**Example 1:** Nancy Hunter creates a revocable trust into which she

transfers her bank accounts, investment accounts, and real estate. Nancy names her daughter, Judy Palmer, as successor trustee. Now, if Nancy loses the ability to manage the trust assets, Judy will take control.

Before naming someone as successor trustee, consider this question: Is this person able and willing to serve? If not, a corporate co-trustee may be the answer. The latter solution will cost money but could be less expensive than losses caused by an unqualified trustee.

### Irrevocable trusts

With irrevocable trusts, the grantor gives up control of assets transferred

into the trust. Such trusts can serve many purposes, such as reducing estate tax, protecting beneficiaries who might handle money unwisely, and providing strong creditor protection. Modifying an irrevocable trust can require considerable effort and expense, if it can be done at all.

### Other components

A thorough estate plan also might include a letter of instruction, durable power of attorney, and health care directives. The lawyer who drafts your will and any trusts you might desire can let you know what else you'll need for a comprehensive estate plan.

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## Moving your business to a low-tax state

As explained in the April 2018 *CPA Client Bulletin*, the Tax Cuts and Jobs Act of 2017 has put a cap on state and local tax (SALT) deductions. Beginning with your 2018 tax return, if you itemize deductions, you can count no more than \$10,000 a year of SALT deductions for income and property tax on a single or joint tax return (you can choose to include sales tax instead of income tax). SALT deductions (other than those for state and local *income* taxes) are not limited if they relate to income from a trade or business or for property held for the production of income.

Therefore, paying large amounts of SALT will become more painful because there will be scant relief from a federal income tax deduction. The more you pay in SALT each year, the more the \$10,000 ceiling will hurt. In addition, if you plan to make a profitable sale of your company within the foreseeable future, the state income tax on your sale could be substantial, yet not deductible.

Moreover, the new tax law's SALT cap could have a ripple effect on your company. If you have key employees,

chances are they pay relatively high state and local income and property tax because of ample compensation and living in valuable homes. These employees might be thinking of their own tax-related relocation if you're in a high-tax area now.

### Plan yourself first

The idea of moving to a lower tax state could be more appealing now. Such a decision should be based on careful research.

To start, determine whether you want to personally relocate. Moving your business to another state while continuing to live in your current state may cause problems. Say you have decided to move your business from New York to Florida. It may be difficult to convince New York that you have moved your company to



Florida if your own residence is still in Manhattan or Brooklyn.

If you do decide to personally relocate, your claimed change in residence will be more convincing if you sell your home in New York and cut all ties. That could include getting a new driver's license, voter registration, local bank account, and so on. You might have to put young children into school within the new state. If you choose to keep other New York real estate after moving, it may be costly. New York will seek to tax rents on property within its

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borders, and the property, if still owned at death, will be subject to New York state estate tax.

Besides comparing tax burdens, look at other major costs, as well. Will home and auto insurance be higher or lower after a move? How will health insurance be affected?

If your spouse works outside your company, will there be job opportunities in the new area? Determine if the total savings will justify the disruption that a move will create.

### Getting down to business

Once you've decided that a personal move would be cost effective,

analyze what a business move would entail. If your business is very small, perhaps just yourself and an assistant, relocating may be fairly straightforward. As long as it will pay off for your family, moving to save money paid for state and local tax could make sense.

With larger companies, though, more factors must be considered. You might have to deal with relinquishing office space and finding suitable new business premises. Other decisions could involve dealing with business property, offering employees help to relocate, providing severance pay to those who will be left behind, obtaining various licenses and registrations in

the new jurisdiction, and so on. The sooner you move and the longer you operate in the low-tax state, the greater your chance of avoiding tax from your old state on a sale of the company.

The bottom line is that moving a business may be challenging, but it is doable. Such relocation is implemented all the time by many types of companies. The new tax law, with its limit on SALT deductions, may be the proverbial final straw that gets you going. Our firm can calculate the overall cost savings from such a move and help you deal with the regulatory requirements that might arise.

## Tax calendar

### JULY 2018

#### July 16

**Employers.** For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in June if the monthly rule applies.

#### July 31

**Employers.** For Social Security, Medicare, and withheld income tax, file Form 941 for the second quarter of 2018. Deposit any undeposited tax. If your tax liability is less than \$2,500, you can pay it in full with a timely filed return. If you deposited the tax for the quarter in full and on time, you have until August 10 to file the return.

For federal unemployment tax, deposit the tax owed through June if more than \$500.

If you maintain an employee benefit plan with a calendar year-end, file Form 5500 or 5500-EZ for calendar year 2017.

### AUGUST 2018

#### August 10

**Employers.** For Social Security, Medicare, and withheld income tax, file Form 941 for the second quarter of 2018. This due date applies only if you deposited the tax for the quarter in full and on time.

#### August 15

**Employers.** For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in July, if the monthly rule applies.



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