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2015 Trends for Estate Planning

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The trends this year are important and some proposals could be game-changers. At Cannon we are committed to keeping the industry up-to-date on both the facts and the rumors. I will start with the current situation and finish with some game changing proposals that may or may not happen, but keep us aware of what they are thinking in Washington, DC.

Income Tax

2015 continues the big trend of focusing on Income Tax in estate planning. With the estate tax exemption at \$5,430,000, and continuing to rise from inflation indexing, current law promises to leave well over 99% of Americans with no estate tax burden. For those over the limit, generally, planning remains the same, except that the impact of state level estate tax and state level income tax become factors to contend with. For the average American, well under the estate tax limit, these same two factors are the only tax factors to consider. Some estate tax free limits have much lower exemption equivalents, like \$1or \$2 million, and some have income tax rates that, once combined with the federal income tax can exceed 50% versus the estate tax rate of only 40%. The Affordable Care Act (a.k.a. Obamacare) is beginning to demonstrate its cost in the form of an additional nearly 1% tax on incomes over defined limits and almost 4% on investment income. All of this means that the wealth market client is more and more sensitive to state income taxation. This has caused significant income migration in the past ten years. It is now extending the migration to irrevocable trusts that create an incomplete gift, since estate tax saving is not being sought, but is a non-grantor trust for income tax purposes to shift the income taxation to the state of trust administration, rather than flowing through to the grantor. The opposite technique is often used in the Ultra High Net Worth market with Grantor Trusts being used to either disregard transactions, like sales, and yet tax the Grantor rather than the trust to leave the trust undiminished by income tax and the Grantor's estate lessened by the tax burden on behalf of their beneficiaries.

Capital Gains Tax

The other side of the Income Tax strategy is finding ways to increase cost basis. Since the average American no longer is subject to estate tax, ensuring the capital gains tax does not unnecessarily reduce wealth generally means NOT gifting during life and thus transferring the basis, an old standby in estate planning. Holding the assets until death and receiving the "step up" in basis at death, now becomes the standard. In the Ultra High Net Worth world, this gets complicated. Should I transfer now reducing the estate exposure but forgoing the basis adjustment, or should I hold until death getting the basis adjustment but being exposed to estate tax? Many factors including the type of gain, amount of gain, expectation that heirs might sell, state of residence of the grantor and beneficiary, and others come into play. Even young, wealthy individuals are considering ways of tax free gifting low cost basis UP to living parents or

grandparents who could then leave those assets back to the original owner but with a tax free estate and a stepped up basis.

Portability

Since entering the system in 2011 and becoming permanent in 2013, the ability to leave one's spouse any estate tax exemption left unused at the settlor's death. The so called "portability" vs. the traditional A-B trust has been the pair of options to play against one another. Parts of the debate include a second step up in basis, income tax entity status, full use of the GSTT exemption which is not portable, state estate tax, estate tax free growth outside of the survivor's estate, but also just the simplicity vs. complexity of the plans. In our classes we have been providing extensive coverage of these factors to help identify the questions to ask that help lead through the matrix of issues.

Proposals

President Obama in the State of the Union (SOTU) address brought up some of these themes as well in the form of POTENTIAL changes. I stress potential because what I am about to say is not law, just the wishes of the current administration. One proposal was to increase the top capital gains tax rate and qualified dividend tax rate to 28% for top income tax filers. Just imagine the impact that would have on the discussions above, increasing the value of the estate tax step up in basis. Couple that with an administration-long desire to reduce the estate exemption to \$3.5 million not indexed for inflation and a desired estate tax rate increase to 45%, and the estate tax burden could increase as well. In the SOTU, the President presented another idea related to capital gains, basically taking away the free basis step up we enjoy at death. In its place Gifts to non-charitable beneficiaries would trigger capital gains realization with certain dollar limit exceptions and special exemptions for closely held business. Likewise, transfers at death would be capital gain realization events, again with exemptions around \$200,000 for married couples and for personal residences at limits similar to the current income tax limits. It is my opinion that these proposals will not get passed in the last two years of a Presidential term, but even if they don't, they set a conversation for the 2016 Presidential candidates to discuss and give us some insight into the changes Washington, DC may wish to enact in the future. These proposals would not make the estate tax apply to middle class Americans, but they would certainly have a similar effect without changing the estate tax rules.

Since this is an article on Trends and not an analysis of the law, I have kept information general to get the point across without trying to get mired in the details. See your tax or legal advisor for specific application. I hope that this information has been helpful to you and your clients and we look forward to seeing you at one of our educational events to discuss the details.

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