Adam Smith Advisors

A Cherry Tree Affiliate

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INVESTING QUOTE OF THE MONTH:
"Everyone is a long-term investor when the market is going up." – Jonathan Clements

ESTATE TAX LAW CHANGES FOR 2018

There are several significant changes in estate tax laws for 2018, which are very positive for wealthy families. The federal estate/gift tax exemption level doubles in 2018 to $11.2 million per person, the Minnesota estate tax exemption increases to $2.4 million per person, and the annual gift tax exclusion amount increases to $15,000 for each person gifted to.

President Trump's Tax Cut and Jobs Act dramatically (but temporarily) increases the federal estate/gift tax exemption amounts to $11.2 million per person. Since this exemption amount is portable (shareable among couples), a couple would be able to exclude twice that amount or $22.4 million from the estate tax. Thus, only very wealthy families will be subject to the federal estate tax during the years 2018-2025. The federal estate tax rate remains at 40%.

This significant change in estate tax law is a good reason for wealthy families to review and update their estate plans, as many estate plans (wills, revocable trusts) use formulas based on the exemption amounts at the time of death to determine how much money is moved where upon death (often for the first spouse). This is very common if you currently have a Bypass Trust, Credit Shelter Trust, A&B Trust, or Marital Trust.

People should be aware that this dramatic increase in the exemption amounts expire at the end of 2025, absent any further Congressional action. At that point the exemptions would be cut back to previous levels (reduced by about 50%). Changes could come even sooner, depending on which way the political wind is blowing over the next several years. This window of very high (but temporary) estate tax exemptions (years 2018-2025) offers significant planning opportunities for wealthy families. Clients who can afford to do so are being encouraged by estate planning experts to consider using their large exemptions now for gifting, in case the current generous estate tax law does expire in 2025 (or sooner). For couples, this would benefit anyone with $11 million or more in assets.

Wealthy couples could consider gifting now (over the next several years) to get some of the "excess" assets they don't need for their own lives out of their estate. These gifts could be made directly to their kids/grandkids, or to new or existing irrevocable trusts for the benefit of their children/grandchildren or to charities. Another advantage to gifting now is that it removes all the post-transfer appreciation from your estate as well. We can help wealthy families with the financial planning necessary to decide how much they might want or need to keep for themselves, and how much of their current large exemption amounts they can afford to utilize for gifting over the next few years.

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It is also important to keep in mind that lifetime gifts made now, unlike assets transferred at death, are not entitled to a stepped-up cost basis. Thus, lifetime gifts can increase the income taxes paid by the recipient if/when they sell a gifted asset that has a large capital gain. So when considering a lifetime gift it is important to weight the potential estate tax savings of the gift against the potential higher income taxes that will be due on the eventual asset sale. Factors to consider when deciding on a lifetime gift are your current age, the size of your estate, how much you need to retain for yourself, and the amount of the capital gains in your investments. You can also gift specific assets that have smaller capital gains as lifetime gifts, and hold the assets that have enormous capital gains until death. We can help you run the numbers to figure out the likely best course of action for you.

The annual gift tax exclusion has also increased in 2018 to $15,000 per person (from $14,000 last year). This is the amount each person can gift tax-free per year, and they can gift this amount to as many people as they want each year. A couple can each gift $15,000 per year, for a total of $30,000 per year, tax free, to as many people as they want. This is an excellent tool for wealthy families to move money to the next generation (or two) over time. A couple can gift to each child (and their spouse) a total of $60,000 per year ($15,000 times four). Many families gift money to their kids/grandkids Roth IRA accounts at up to $5,500 per year once the child/grandchild starts having earned income.

The Minnesota estate tax exemption amount also increases in 2018 to $2.4 million per person. This exemption amount increases to $2.7 million in 2019, and to $3.0 million per person in 2020. The Minnesota exemption amount is not portable (shareable) among couples, so you need to do some planning such as dividing the assets held by each spouse to get the full benefit. If done properly (at least $3 million in assets in the name of each spouse), in 2020 a couple can exclude $6 million in assets from the Minnesota estate tax. Thus, most people will not be subject to the Minnesota estate tax going forward. The Minnesota estate tax rate ranges from 13% to 16% depending on the size of the estate. People should be aware that gifts made within three years of death are included in the estate for tax purposes. The Minnesota estate tax law is currently the subject of ongoing debate, so we view the current somewhat more generous exemption amounts as possibly subject to change in the future.

> **"While much of this letter on estate planning applies to wealthy people, everyone should have a basic estate plan"**

While much of this letter on estate planning applies to wealthy people, everyone should have a basic estate plan. A basic estate plan includes wills, a healthcare directive (who makes decisions for you about care if you are not able to), and a financial power of attorney (who can make financial decisions for you if you are not able to). These three basic documents are very important and can be put together by an estate attorney at an affordable cost. Beyond these basics people often consider revocable living trusts (to avoid probate), irrevocable life insurance trusts, and many other trusts that are too numerous to mention.

This letter is a general review of the recent tax law changes, but each person's financial situation and estate plan goals are unique and different. Please contact us and/or your estate planning attorney if you have any questions about your estate plan. If you do not currently have a good estate planning attorney, we can refer one to you.

Adam Smith Advisors, LLC (ASA) provides unique wealth management services for a select group of client families to help give them peace of mind. Author Keith Tufte, (CIO of ASA) has over 25 years of successful investment management experience as a Wall Street Analyst, Mutual Fund Portfolio Manager, Director of Equity Research for a major mutual fund firm, Hedge Fund Portfolio Manager, and Wealth Management Advisor. Please FORWARD this e-mail to friends/relatives/business associates that you think may have an interest. Please see our website at http://www.cherrytree.com.

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