Year-End Estate & Charitable Planning Considerations for Individuals

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Rounding Out 2018: Year-End Estate and Charitable Planning Considerations for Individuals

As we head into the fourth quarter of 2018, what perspective, if any, has been gained with respect to the Tax Cuts and Jobs Act of 2017 (the “Act”) and its impact on individuals’ 2018 tax liability, spending habits and potential charitable giving?

What Were the Initial Predictions for the Act and its Impact on Individuals? Were They Correct?

As soon as the Act was passed, the overall consensus was that it would result in fewer taxes for most individuals. The Tax Policy Center findings advised that the Act would reduce taxes on average for all income groups in the years 2018 through 2025 (the effective years for most of the enacted tax changes), with only 5% of taxpayers actually projected to pay more in income taxes in the year 2018[i]. Most predictions showed the gross domestic product (“GDP”) increasing for 2018. Much of the initial analysis of the Act focused on the increased standard deduction, the resulting decrease in taxpayers who would itemize, and the elimination of the personal exemption and state and local income tax (“SALT”) deduction. A popular focus at the beginning of the year was also on the supposition that fewer itemizing taxpayers would result in a substantial decrease in charitable deductions, as those taxpayers would no longer receive a direct tax benefit from any such deduction.

Because individual tax returns for the 2018 calendar year are not due until April of 2019, we do not yet have real data to review in order to determine the actual reduction in itemizers; however, there are many current indicators which can provide insight to individuals and charitable organizations as both proceed into this year’s fourth quarter. Additionally, the IRS has issued several notices throughout the year in response to the Act, which attempt to provide more insight on how the Act impacts issues such as withholding amounts, tax estimates as well as the relationship between the SALT and the charitable contribution deduction. An analysis of current economic trends as well as legislative reactions from various states (or proposed legislative reactions) provides us with additional understanding of what individuals can expect.

Analysis released at the end of June 2018 by Kiplinger shows a projected increase in GDP of 2.9% for the year, stating that tax cuts and the resulting rise in consumer spending and stronger business investment are the cause of the boost over the 2017 2.3% increase.[ii] Kiplinger projects a minimum of a 3% increase in consumer spending for the remainder of this year.[iii] GDP has long been an indicator in predicting consumer spending, but it can also indicate trends in charitable giving. In fact, data collected from as early as 1976 through the present day by Giving USA Foundation indicates that charitable giving remains, on average, around 2% of GDP as well as 2% of disposable income.[iv] As such, charitable organizations can expect that individuals will give more as GDP and their disposable incomes increase in a manner consistent with their prior giving. Early this year we could only predict that disposable personal income would increase, but now we can see from real economic indicators that, in fact, disposable personal income has increased in 2018 and as a result consumers are spending more.

Who Will Continue to Itemize and How Are the Charitable and SALT Deductions Impacted by the Act?

For most individuals, the following highlights of the Act are the most important and seem to have experienced the most attention in the press:

1. The Act nearly doubles the standard deduction (from $6,500 to $12,000 for single filers and from $13,000 to $24,000 for married filing jointly), which will result in fewer tax filers itemizing their deductions;

2. The Act maintains seven (7) federal income tax brackets for individuals; however, the marginal income tax rate is reduced at virtually every level;

3. The child tax credit is doubled by the Act, the refundable portion of that credit is increased and the phase-out limitations for qualifying families are increased substantially (threshold is $400,000 under the Act for married taxpayers filing joint returns compared with $110,000 for 2017);

4. The SALT deduction is limited to an aggregate of $10,000 for all itemizers other than married filing separately, who are then each limited to $5,000; however, individual tax filers and those filing as married filing jointly both are entitled to deduct up to $10,000 for state and local taxes; and

5. The fact that fewer individuals will itemize their deductions has led to speculation that fewer individuals will make charitable donations as those who no longer itemize will no longer receive a direct tax benefit in the form of a deduction.

While it is true that fewer tax filers will itemize their deductions, this fact alone should not lead to fewer charitable deductions. In fact, the income group that claims the majority of charitable contribution deductions, that range between $200,000 to $500,000, will nearly all continue to itemize their deductions, thus retaining their tax benefit associated with their charitable contributions.[1] If past history is any indication, charitable organizations can expect charitable contributions to increase as Americans' disposable incomes increase.

The limitation on the SALT deduction will impact very high income earners who live in states with high income taxes the most, as these individuals are more likely to have combined state and local income taxes that will significantly exceed the $10,000.00

[1] According to the Congressional Research Service (CRS) report for 2014 (the most recent calendar year with analysis available), when you move to the income range of $200,000.00 to $500,000.00 you find that 93% of these tax filers itemized with an average amount claimed by each filer of $43,131.00, which far exceeds the new standard deduction amounts under the Act. *See* Congressional Research Service/ 2017 Data Analysis for Itemized Deductions for Individuals.

threshold. While these taxpayers will not be able to deduct as much as before, their overall marginal rate of reduction should still provide them with a lower tax bill and more disposable income.

How will individual states respond? Different states have already responded to the limited SALT deduction by proposing that individuals in those states pay the taxes they would otherwise pay to the state government for state and local income and/or property taxes instead to designated funds that would be controlled by those same state or local governments. The payments made by taxpayers to these funds would then qualify the taxpayer for credits against the state or local taxes they would otherwise owe. The goal of these legislative proposals in different states is to allow the taxpayer to effectively deduct 100% of all payments made to the "funds" for state and local taxes as a charitable contribution deduction. The IRS, in Notice 2018-43, reminded taxpayers that "[d]espite these state efforts to circumvent the new statutory limitation on state and local tax deductions, taxpayers should be mindful that federal law controls the proper characterization of payments for federal income tax purposes." Substance over form will surely lead to the IRS treating any such deduction as a SALT deduction, subject to the $10,000 limitation, rather than as a charitable contribution deduction.

End of the Year Estate Planning Considerations

Should advisors be rushing any end of the year estate planning changes for clients and/or recommending any large gifts in trust or otherwise for non-spouse family members? Because the Act nearly doubled the federal estate and gift tax exemptions for individuals, our clients can now either gift during their lifetimes or leave to a non-spouse at their death $11.18 million in assets, and for our married clients, they can structure their estate plan to leave $22.36 million with no imposition of gift or estate taxes. Obviously most of our clients have no estate tax problem, and didn't even before passage of the Act, but for our wealthy clients is there a hurry to get changes in place prior to year end? Maybe.

Because the Act sunsets these estate and gift tax changes at the end of 2025, and because we cannot predict whether or not a client's death will occur within this window, most estate planning considerations are still being made with the assumption that the exemptions will revert back to $5 million per person (indexed for inflation) beginning January 1, 2026. Because of this potential reversion, the Act creates this window of time where individuals who would have a taxable estate under the 2017 levels, but not under the current levels, to make current gifts to take advantage of this excess. If we have a client with an estate in excess of $5 million and they want to ensure that they will not have a taxable estate in the event they die after 2025, that client has the opportunity to gift that excess over $5 million now to his or her children and/or grandchildren, in trust or otherwise. The current $11.18 million is an exemption from not only estate, but also gift and generation skipping transfer taxes, so our clients can spread this gift out over several generations and absorb not only this additional estate tax exemption but also his or her generation skipping transfer tax exemption, subject to a possible risk of the IRS clawing back the additional exemption[2]. So long as these gifted assets remain in trust they will never be included in a lower generation's estate for estate tax purposes.

The impetus to getting those wealthy clients to make these gifts is the impending sunset of the Act in 2025; however, there is also the threat of Congress repealing the Act or some part of it prior to that time. Planners are hopeful to obtain guidance from the Treasury Department as to whether or not the "claw" back risk is of real concern and if and when we do receive that guidance, we can expect to see many of these gifts taking place.

Education of Donors Regarding End of Year Contributions for 2018

In 2018, more than any other prior year in recent history, it is imperative that charitable organizations, estate and financial planners educate potential donors regarding end of the year donations. Individuals need to be advised of the following important facts relevant to the Act:

- All but 5% of tax filers are expected to have a lower tax bill for 2018[v] and most households with income levels exceeding $100,000.00 will continue to itemize their deductions[3] and so will be able to benefit from the charitable contribution deduction.

- The charitable contribution deduction has been enhanced by the Act, with taxpayers now being able to deduct cash donations up to 60% of their adjusted gross income (versus 50% under prior law).

- In order to take advantage of the Qualified Charitable Deduction (aka the Charitable IRA Rollover), individuals over 70 ½ must fill out the appropriate paperwork with their IRA custodian to allow their required minimum distributions and even larger amounts up to $100,000.00 to be paid directly from their IRA to a qualifying charitable organization. Donors need to have this process completed prior to year-end to ensure receiving credit for their

[2] There is speculation that Congress may "claw" back any use of the additional exemption after its sunset, basically meaning that if individuals made gifts during this time period to use up that additional exemption, those gifts would be brought back into the estate at the donor's death, thus subjecting those gifts to an estate tax. This claw back is very unlikely and experts suggest that it would be subject to many challenges based on overreaching. The IRS has requested that the Dept. of Treasury issue regulations to clarify this issue.

[3] In the $100,000.00 to $200,000.00 income range, 77% of these tax filers itemized deductions with the average amount claimed by each filer of $25,598.00, according to the Congressional Research Service (CRS) report for 2014. *See* Congressional Research Service/ 2017 Data Analysis for Itemized Deductions for Individuals.

required minimum distribution prior to the December 31 deadline. All potential donors need to be made aware of this option as it benefits taxpayers at *all* income levels and is available to and benefits *both itemizers and non-itemizers*, as the income distributed to the charitable organizations completely bypasses the individual's taxable income. Remember to advise donors that donor advised funds and supporting organizations are *not* qualifying recipients of these rollovers.

- As always, advise donors to charge their donations on their credit cards and/or write and mail that check prior to December 31 to ensure credit is received for the donation in 2018, as these rules were not changed by the Act.

Conclusion

As we close out 2018 after passage of the largest overhaul of the United States Tax Code this country has seen in nearly 30 years, financial and estate planners have now had several months to analyze initial data and economic factors as well as to get more comfortable with the actual provisions of the Act. At this stage we can better advise our clients that most of them will pay fewer taxes next year and can assist them more knowledgably regarding end of the year planning. Americans are responding to their increased disposable incomes in a big way, as can be seen in the large growth in consumer spending. Despite the fact that some taxpayers will no longer itemize their income tax deductions due to the increased standard deduction, they should continue to make charitable donations and possibly even be more generous as they have more money left over from which to give. As all of this reality sets in, end of the year pushes by charitable organizations are likely to achieve big dividends, and, hopefully, 2018 will end up breaking even more records than its predecessor year.

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[i] The Tax Policy Center/ Analysis of the Tax Cuts and Jobs Act / December 11, 2017

[ii] Kiplinger / GDP to Climb 2.9% This Year, Kiplinger's latest forecast for the GDP growth rate/ June 28, 2018

[iii] See Endnote ii above

[iv] Giving USA Foundation/ Giving USA 2016/ Giving USA Data Tables for Charts in the Numbers/ Individual giving as a percentage of disposable personal income (DPI), 1976-2016 and Giving USA Foundation/ Giving USA 2016/ Giving USA Data Tables for Charts in the Numbers/ Giving as a percentage of gross domestic product (GDP), 1976-2016

[v] See Endnote i above