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Year-End Estate, Charitable/IRA, and Gift Tax Planning for 2019

Dear Clients and Friends,

We wish you a happy holiday season.

As we approach the end of 2019, we wanted to take a moment to reach out to you and remind you that now is a great time to take advantage of certain gift and estate tax planning techniques as well as update you on a number of recent developments in estate and gift tax legislation. We have prepared this year-end letter for your consideration with an objective of giving you some time to take action if you choose to do so. Any action requires review with your CPA and/or tax attorney and should not be taken relying upon this letter. This is not intended to be and is not a comprehensive list, in part, to maintain brevity.

2020 - $11,580,000 Basic Exclusion Amount. The Tax Cuts and Jobs Act (the "2017 Tax Act"), enacted December 22, 2017, effective January 1, 2018, significantly increased the Federal estate, gift, and generation skipping transfer ("GST") tax exemptions (referred to as the "Basic Exclusion Amount"). The Basic Exclusion Amount serves to avoid such taxes to the extent of the exemption. Effective January 1, 2020, the Basic Exclusion Amount increases to $11,580,000 for a single person and $23,160,000 in the aggregate for married persons and will continue to be inflation-adjusted annually. These exemptions are reduced by prior taxable gifts. To the extent one's estate exceeds the Basic Exclusion Amount the estate tax and gift tax is 40 percent. The enhancement of the Basic Exclusion Amount to its current $11,580,000 level sunsets after 2025 at which point the exemption will be reduced by 50% unless Congress takes action. The future level of the Basic Exclusion Amount is dependent, at least in part, upon which political party is in power, as several of the estate tax proposals that have been presented would significantly reduce the Basic Exclusion Amount (e.g., Senator Bernie Sanders proposed reducing the Basic Exclusion Amount to $3.5 Million (the level that existed in 2009)).

Annual Exclusion Gifts to Reduce Estate and Gift Tax. In 2019, you may give up to $15,000 per recipient to an unlimited number of recipients without using your Basic Exclusion Amount or paying gift tax. Spouses often join together to double that gift amount to $30,000. This tax benefit is called the "annual exclusion," and it is only available for outright gifts to individuals and certain types of gifts in trust. The annual exclusion amount will change with inflation over time. However, it will remain at $15,000 in 2020. Your tax advisors can help you transfer assets over time within your annual exclusion limits.

In addition to the annual exclusion, you can pay for certain educational expenses (the "educational exclusion") and medical/dental expenses (e.g., orthodontist bills and health insurance premiums) (the "health care exclusion") for an unlimited number of beneficiaries. As long as you pay the service provider directly, these gifts are excluded from any gift tax or use of your Basic Exclusion Amount.

The health care exclusion applies only to expenses that are not reimbursed by insurance. The educational exclusion applies only to tuition, not to related expenses (e.g., books or room and board) and can be made through 529 plan contributions. The biggest gift tax advantage of 529 plans is that a donor can contribute more than $15,000 in one year and treat their contribution as if it was made evenly over 5 calendar years. Thus, assuming no other anticipated gifts to the 529 plan beneficiary, a donor may contribute $75,000 to a 529 plan for that beneficiary in 2019 and have no taxable gifts to report. The donor, however, must make an election on a timely filed gift tax return. If you are married and your spouse also makes such a gift, the total gift for 2019 to a 529 plan account could be $150,000.

The IRS only allows the benefits listed above if the donor makes the payments properly and timely, so please talk to your tax advisor about how to make the payment in a way that allows you to qualify for such exclusions.

Required Minimum Distributions from Non-Roth IRAs. The minimum distribution rules require that a taxpayer begin to take distributions from qualified plans and IRA accounts at a certain age. Typically, the required beginning date for such distributions is April 1 of the year after the year in which a taxpayer turns age 70 ½. The Pension Protection Act of 2006, permits individuals who are at least 70 ½ years of age to contribute up to $100,000 from an IRA to a qualifying charity without recognizing the assets transferred as income. As a result, individuals age 70 ½ or older may direct up to $100,000 from their individual IRAs to qualified charities each year tax-free. There is no requirement that the entire $100,000 amount is made in one transfer or that the entire amount goes to a single qualified charitable organization. Rather, such distributions can be made in multiple direct transfers. Additionally, such distributions (i) may be excluded from the individual's gross income, (ii) count towards the amount required for the minimum distribution, and (iii) may be an effective way to reduce income taxes as the IRA annual distribution to a qualifying charity is no longer taxable income. This is beneficial, for example, where charitable deductions would be limited or where the taxpayer otherwise would not itemize deductions. Whether direct charitable gifts are tax advantaged requires consideration of your income, other deductions, and whether you would otherwise itemize your deductions. Your CPA and/or attorney should help with this analysis.

Most contributions to public charities – other than supporting organizations – are considered qualified charitable contributions. Whereas distributions from IRA accounts to Donor Advised Funds administered by public charities are not considered qualified charitable contributions for purposes of the IRA $100,000 charitable contribution rule discussed above. However, distributions from IRA accounts to qualified charities, such as the Miami Foundation, can qualify for the IRA $100,000 charitable contribution rule and can be designated pursuant to a "Designated Fund Agreement." The donor of the designated fund agreement may (i) designate specific nonprofit organizations (provided such nonprofit organizations have 501(c)(3) status) that will receive such IRA distribution and (ii) specify how much or what percentage of the distribution shall pass to each nonprofit organization annually, provided the designations are fixed prior to the donor's contribution and the donor will not thereafter have the ability to suggest other charities or allocations from assets held pursuant to the Designated Fund Agreement. Designated Funds can be created through a contribution to The Miami Foundation.

Individuals must instruct their IRA trustee to make a qualified charitable distribution and the distribution must be sent directly from the IRA company to the charity. It is important to note, however, that IRA administrators need some time to process these payments so it is suggested that action is taken long before the year-end and for those considering a gift to a Designated Fund, action should be taken now. For those who want additional information from the Miami Foundation, please call or email Janell Kaplan (JKaplan@miamifoundation.org; 305-357-2081).

Opportunities with Low Interest Rates. Intra-family loans are another technique for shifting wealth between family members. The transaction is premised on the assumption that the funds loaned will appreciate at a greater rate than the interest the IRS requires to be charged on the loan. The required interest rate is updated monthly by the IRS and is referred to as the Applicable Federal Rate ("AFR"). The December 2019 AFRs: (i) for loans of three (3) years or less is 1.61%, (ii)for loans of more than 3 years but not greater than 9 years is 1.69% and (iii) for loans of greater than 9 years is 2.09%. These rates assume annual compounding. These rates are extremely low compared to historical averages.

To see how easily this transaction can work, consider of a loan of $1 million to your children or a trust for your children. If the money grows by 7% annually, your children or the trust for their benefit will earn $70,000 per year and yet only owe $16,100 in interest (assuming a 3 year loan in December of 2019). The additional growth of $53,900 is a tax-free gift to your children (or to their trust). This rate is locked in, even if interest rates increase during the term of the loan.

This may also be an opportunity to consider refinancing intra-family loans or promissory notes received as part of a prior intra-family sale, which include interest at significantly higher rates. Any such negotiation should be at arm's length and if the interest rate is reduced, taxpayers should consider having the borrower give the lender consideration, such as a prepayment of a portion of the principal or a reduction of loan duration, in exchange for the reduction of interest rates to the current AFRs.

Another low interest rate opportunity is a grantor retained annuity trust ("GRAT"), whereby a grantor creates and funds a trust that pays the grantor an annual annuity payment such that the present value of the payments is almost equal to the original contribution of the trust. In other words, the grantor receives back the initial gift, plus a pre-determined interest rate, that is derived using rates similar to the previously mentioned AFR rates but for GRATs the IRS rate is based upon the "7520 rate." The 7520 rate for December 2019 is 2.0%. Any earnings (including income and growth) in excess of this rate pass to the GRAT beneficiaries at the end of the GRAT term, free of gift and estate tax assuming the creator of the GRAT survives the term. This is an effective method to transfer the growth on an appreciating asset while making little or no taxable gift. While a GRAT is an interesting strategy to transfer wealth to the next generation, there may be pitfalls associated with using a GRAT to transfer that wealth to grandchildren and beyond such as mortality risk and lack of generation-skipping planning benefits.

Review of Estate Planning Documents. We recommend that estate plans be reviewed periodically (at least every three years) to ensure full use of the Basic Exclusion Amount and to determine if existing documents include a formula gift referring to the Unified Credit, which could result in excessive assets passing to persons other than a surviving spouse, leaving insufficient assets for a surviving spouse, and creating potential adverse income tax consequences. Such formula gifts were typical when the Basic Exclusion Amount was much smaller but could now result in unanticipated gifts to children at the expense of a surviving spouse. Your Wills and Trusts should be reviewed to determine if your beneficiaries, Trustees, and Personal Representatives are in accordance with your current desires.

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We hope that the information in this letter is useful in your year-end planning. There are many other potential planning techniques that are beyond the scope of this letter. For a more comprehensive discussion on these topics, see our *6 Question 2018 Gift Suitability Analysis* that applies equally as well for 2019 and 2020 gifts.

6 Question 2018 Gift Suitability Analysis
Available at http://leimbergservices.com/all/LISINelson&NelsonPDF3_22_2018%20.pdf

If you wish to take advantage of any of the planning techniques that we have described, please feel free to call our office if you are a client or your attorney, CPA and/or financial planner if you are not. I hope that the remainder of 2019 will be happy and healthy for you and your family.

Very truly yours,

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