MCF Private Trust

BASIS AND INCOME TAX PLANNING FOR THE ESTATE PLAN

Since 2011 we have been in a world of record high estate tax exemptions. As a result, less than two tenths of one percent of the population is subject to estate tax. Naturally, as tax law changes, so do strategies. The bad news is the right strategy depends very much upon the individual situation.

Background; Estate Planning: The old paradigm was with success came an estate tax of over half one's wealth. Limitations of $600,000 estate tax free and rates cresting at 55% created a mindset of gifting non-essential assets, particularly those expected to rise in value over one's life expectancy, out of one's estate. After all, the top estate tax rate was almost three times the capital gains tax rate. Contrast that with today's environment. The estate tax rate about double the capital gains rate and the dollar amount exemptible is significantly higher than what it was just 20 years ago. Naturally estate plans should adjust to the changing environment.

To be clear estate planning is not about taxes, but it is by taxes. Whenever one analyzes tax results, the point of view is the client's "intent" should be respected above all. It is simple to reduce the estate tax to zero and the income and capital gains tax on the estate to zero: just leave everything to charity. The end game is about achieving the client's desired outcomes in the most tax efficient manner.

Estate planning outcome; Variables matter: There are many variables to consider in the planning process and each member of the planning team has a role. The move toward income tax planning elevates the tax professional's role; prepare models which incorporate alternatives. Estate size is inherently a primary consideration. As an example, if one's estate is under the basic exclusion amount of $11,200,000 in 2018 (projected to increase to $11,400,000). It is also important to consider these high exemptions are set to sunset in 2025 and revert back to around $6,000,000 per person. For couples, that number doubles. One's estate size varies, however, by several factors: life expectancy, expected return on investments, rate of spending, even state of residence. Critical to the equation is one's beneficiaries, since leaving money to a U.S. citizen spouse still delays the estate tax and, as mentioned, leaving money to charity eliminates the tax. Even the type of income and gain can make a huge difference in the tax rate applied since income taxes include capital gains taxes. Lest one forgets, marital status matters for

the marital deduction and for the number of exclusions available. Incorporate portability and even the chance of future marriage, or remarriage change the provisions again. Not to mention other circumstances that are hard to know for sure but of consequence, i.e. one's state of residence at death and even the heirs states of residence.

Cost Basis; Transfers: Since, for the average American, estate taxes are no longer an issue, reminding ourselves of the effect transfers have on cost basis is important. When gifting assets, the cost basis stays the same to the recipient. For example, one paid $10 for a stock (at a given point in the past) which is now worth $100. That one gives said stock to another. Gift tax imposes the fair market value ($100), but the recipient still retains the $10 cost basis. Contrast that with the effect of death. With the same fact set, one leaves the stock to another at their death. Estate tax imposes the fair market value ($100), however, the cost basis is now adjusted to that same value ($100) to the recipient; $90 in capital gain vanishes. Thus, if it is not likely that one will have a taxable estate it generally behooves them not to make gifts of appreciable assets.

Historically, another benefit of gifting assets was the likelihood of the recipient having a lower tax bracket. If the client is holding the assets, and in a higher or the highest tax bracket (37%), we then must consider the income tax effects their investments play in the overall plan.

Investments previously served as a reliable area to find tax efficiencies: tax-free versus taxable bonds, the recent years' application of special rates on qualified dividends, as well as the substantial difference between short-term versus long-term gains. Presently, a new factor enters consideration; the application of an additional tax on those with substantial investment income. In order to aid in funding the Affordable Care Act's national healthcare system, those who have net investment income in excess of certain thresholds (e.g. $200,000 for singles, $250,000 for married filing jointly) an additional 3.8% is added to their tax rate. Impact spreads to virtually all irrevocable trusts, the income threshold for which is only $12,750 in 2019 before being subject to this additional tax. A wider disparity in the rate differential between taxable and tax free bonds. Even retirement distributions, which are excluded from net investment income, may then be taxed less than other ordinary income.

Once more, strategies to address one's situation will vary based on the variety of factors discussed previously. Some of those options may include: identifying which assets would benefit most from a step up; how to step up the basis of assets held in an irrevocable trust which is not normally subject to estate tax; even the operation of corporations or partnerships, whose restrictions to minority members caused discounted valuations in transfers, may no longer desire such a discount and the lower change in cost basis that would result. An estate planner may consider incorporating into their documents special powers which grant protectors distinct abilities to grant powers to beneficiaries in order to create inclusion. Likewise, wealthy younger clients may consider zero-value transfers to living parents or

grandparents to receive the step up in basis should the assets later be distributed back to them or into trusts. Further, clients may consider particular trusts such as the tax efficient Charitable Remainder Trust, or irrevocable trusts managed in states with a low or no state income tax.

Conclusion; Simplify: A wish for Washington is to create a simple set of rules with only a few moving parts. In turn everyone could spend more time focusing on our personal passions and interests. Unfortunately, the governing authorities continue to complicate matters with a matrix of intricate choices. Providing your clients with an experienced professional planning team enables you to help them navigate the maze of available choices and to spend more time doing the things they love.

IMPORTANT DISCLOSURE INFORMATION

Trust services provided by MCF Private Trust, a Trust Representative Office of National Advisors Trust Company, a federally chartered, advisor owned, and independent trust company. All investment services are provided by MCF Advisors, LLC, an SEC registered investment adviser. Registration as an investment advisor does not, by itself, imply or denote any level of skill or training. MCF may only transact business in those states in which it is registered, or qualifies for an exemption or exclusion from registration requirements.

This publication contains general information only and should not be construed by any consumer and/or prospective client as MCF Private Trust a solicitation to effect, or attempt to effect transactions in securities, rendering accounting, financial, investment, legal, tax or other professional advice or services. For more information regarding individual or corporate trustees please consult with a legal professional. A copy of MCF's current written disclosure statement discussing our advisory services and fees is available here online.