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Estate Planning Update July 2018 - Income Tax Savings Opportunities Under the New Tax Law

Gifting strategies should be reviewed in light of changes to federal income tax law, the increasing disparity in state income tax rates and the fact that, for many clients, income tax savings will be the primary concern. Similarly, existing and new irrevocable trusts may benefit from a review of income tax factors. Rather than list the many factors involved, we thought a few examples might be helpful:

- Spouse 1 created an irrevocable trust many years ago, which included Spouse 2 and their children and grandchildren as beneficiaries. With the changes in federal and state estate taxes, Spouses 1 and 2 would no longer be subject to estate tax, even if the assets of the irrevocable trust were included in their estates. The trust holds a summer home used by the family that has a low tax basis. If the house were distributed to Spouse 2 and retained by Spouse 2, it would receive a step-up of tax basis on his death, reducing or eliminating capital gains tax on a subsequent sale. Alternatively, it may be possible to change trust provisions in a way that allows the step-up to occur without distributing the house to Spouse 2.
- Mother, who lives in New Jersey and is in the highest state and federal income tax brackets, wants to sell publicly traded stock, but the sale will lead to recognition of a $1 million capital gain. She also is interested in making gifts to her son, who lives in Florida. If she gives the stock to her son, and he subsequently sells it, no state income tax will be due, saving about $90,000. If the son is not in the highest federal income tax bracket, there could be additional savings.
- Father, who lives in Connecticut and is in the highest state and federal income tax brackets, created an irrevocable trust, which is a grantor trust for income tax purposes (meaning that Father pays the income tax on the trust's income, enabling the trust property to grow tax-free for his descendants). The trust has income of about $200,000 per year from a diversified stock portfolio. By relinquishing grantor trust status (making the trust a separate taxpayer) and selecting a trustee with the right state residence (such as a Delaware trust company or an individual residing in New York), the trust can avoid state income tax, saving about $18,000 per year. As in the example above, the savings on a $1 million capital gain could be about $90,000.