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PRODUCT & SERVICE GUIDE

Estate Planning Under the New Tax Reform Guidelines

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Craig Smalley, MST, EA • May. 30, 2018

With the estate tax that has risen to $11.2 million, and if married and you elect portability the exemption doubles to $22.4 million. You might be asking yourself, why do you need to know about estate planning? Very simply, gift tax still exists, as well as there can be tax ramifications to certain things, usually unintended.

Firstly, we have the gift tax. How the gift tax works is you can give one individual $15,000 in one year. If you are married and elect to split your gifts you can give that same person $30,000 in a year. If you give amounts over that, then you need to file a gift tax return, and the amounts over which you gift go against the estate tax unified exemption.

One smart way to give a gift is to give appreciated property. For instance, let's say that you have securities that you have a basis of $15,000, and a fair market value (FMV) of $24,000. You have given a gift of $15,000, and the donee can sell the securities for raw FMV. If that is their only income for the year, there would be no capital gains tax on the sale. If you wait until death, then the beneficiary can elect the alternative valuation method, and pick up the basis of the asset at the FMV six months from the date of death. One word of caution, do not do what most people do. They will put their homes, cars, or other assets in the name of their beneficiaries before they die. This is considered a gift and a gift tax return would have to be filed.

Then there are estate attorneys that we have to deal with, that don't know the first thing about taxes. For example, I had a client have his attorney do estate planning for him. He was in the technology business, and his goal was to sell the business in five years. The IT business was set up as an S-Corporation. Most technology companies are sold by selling the stock to an investor. Had the attorney consulted a tax professional, he would have found out that a C-Corporation was the way to go due to IRC §1202 stock. If the stock commences with the shareholder, then they can sell the stock for up to $10 million tax free. The other way around, the client would have to sell the assets of the business and incur a capital gain. Not to mention, all of the income the client would have to pay personally.

Removal of the family business is another issue that could carry taxable variables. If selling the business to the children, most parents don't want to lose control of the business incase something were to happen, so the parent can step in. If the business is an S-Corporation, the way to do this is to separate the stock into voting and non-voting shares. This doesn't nullify the S-Election because two different classes of stock have not been created. The parent would own 1% of the shares, that are all of the voting shares, and the beneficiaries would hold the other 99% of the non-voting

shares. The beneficiaries buy the business with the existing income of the corporation.

Family Limited Partnerships (FLP) are on the way out. As all 50 states have adopted LLC laws, Family LLC's are more common today than they were a few years ago. The way to capitalize these LLCs and avoid gift tax would be to form the FLLC, give out the membership units of the FLLC before it has asset. Once that is done, you would capitalize the FLLC, thus avoiding any gift tax issues.

A way to control how assets are used, and protect the asset, is through an irrevocable trust. If leaving monies or assets to a young child, or young adult, you may want to consider this option. First of all, once the asset is placed into the irrevocable trust, the asset(s) are protected against creditors. In addition, when the trust is written, you can put stipulations on what the beneficiaries can do with the assets, at what age they can use the assets, put a drug and alcohol provision into the trust document. You can do pretty much what you want. This will remove the asset from your estate, and put stipulations on how the asset(s) or monies are used.

Just because the estate tax exemption has been raised, doesn't mean that there are still income tax variables that need to be considered.

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Craig W. Smalley, MST, EA, is the Founder and CEO of CWSEAPA, PLLC. He has been admitted to practice before the Internal Revenue Service as an Enrolled Agent and has a Master's Certificate in Taxation from UCLA. In practice since 1994, Craig is well-versed in U.S Tax Law and U.S. Tax Court cases, and specializes in individual, partnership, and corporate taxation for high-net-worth clients; entity structuring and restructuring; and representation before the IRS regarding negotiations, audits and appeals. Craig is currently a columnist for CPA Practice Advisor and AccountingWEB and has had 12 books published. His articles have been featured in publications including the Wall Street Journal, The New York Times, and Christian Science Monitor, and he has been interviewed and appeared as a featured guest on numerous radio shows and podcasts. Craig can be reached at craig@craigwsmalleyea.com.

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