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Estate and Gift Dynamics in the Era of the Big Exemption and Election Uncertainty

The Tax Cuts and Jobs Act of 2017 (the "TCJA") was a complicated piece of tax legislation that mostly decreased taxes for individuals and corporations. However, the net effect on an individual (or corporation) is dependent upon the unique circumstances of that individual.

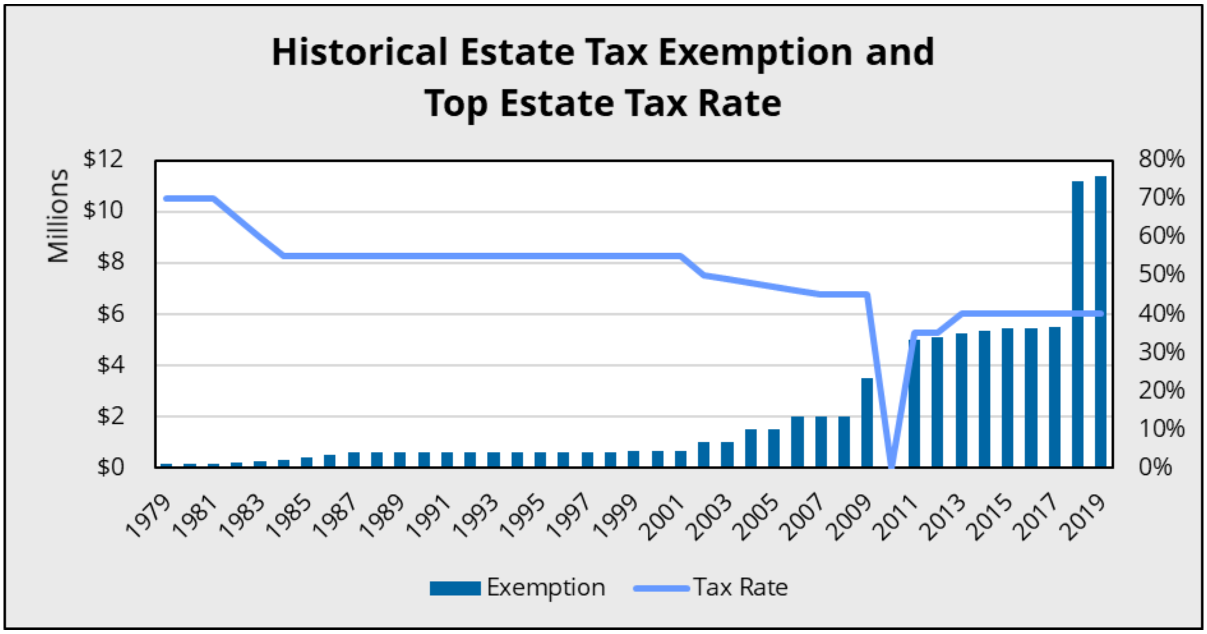
With respect to individual taxpayers, marginal rates were lowered somewhat from 39.6% to 37.0% at the top marginal tax rate, and the tax brackets were increased. However, the 3.8% Medicare surtax that was part of Obamacare remains, and some other changes, like property and state tax limitations, hurt some taxpayers more than rate reductions helped.

C corporations benefited significantly from the TCJA, as corporate tax rates were lowered from 35.0% to 21.0%. Additionally, the owners of certain pass through entities[1] benefited from a provision that allows 20.0% of the owners' income to be sheltered from income tax, effectively lowering the 37.0% marginal tax rate to 29.6%.

The biggest benefit might have come to high net worth families due to the estate and gift (E&G) tax exemption being increased from $5.49 million in 2017 to $11.18 million in 2018 and $11.40 million in 2019, or $22.8 million for a married couple. The E&G tax exemption is indexed each year thereafter. As a result of such a high exemption, the number of estate tax returns subject to estate tax has fallen from approximately 6,500 in 2017 to about 2,000 this year. This exemption is set to lapse after 2025 back to the 2017 level of $5.49 million.

To put this in perspective, the following chart shows the historical E&G tax exemption and the top E&G tax rate since 1979.

1 S Corps, LLCs, and partnerships.



Due to the unprecedented E&G exemption level, there are a number of planning opportunities available for high wealth families. Of course, any E&G plan would depend on many factors, including but not limited to:

- The value of the estate,
- The structure of the estate and the assets held,
- The age and expected life of the surviving spouse(s),
- The investment returns and annual spending requirements, and
- The attitude toward gifting to 2nd and 3rd generations.

An E&G plan should also incorporate one's expectation of the outcome of the next Presidential and Congressional elections, as there is little doubt that a Democratic President and Congress would lead to a lowering of the E&G exemption and an increase in the marginal E&G tax rate.

To add another complication to E&G planning, a win by some in the Democrat field may result in the addition of a "wealth tax." For example, Elizabeth Warren has suggested an annual wealth tax of 2% for wealth above $50 million and 3% for wealth above $1 billion. Bernie Sanders is proposing a tax of up to 8% for wealth above $30 million.

Some wealthy families and their advisors are analyzing the effects of the increased exemption and will get a substantial portion (up to $22.8 million) out of their estate this year (or slightly more next year as its indexed) before it's too late. This could save up to $9.12 million in taxes if the exemption disappears, or $8.69 million if the exemption is lowered to $3.5 million per spouse and the rate is changed to 55% for starters, as Warren proposes. Taking action now would also save on the wealth tax for some individuals, should that ever happen.

To the extent there are assets to gift, whether they are interests in family limited partnerships (FLPs), LLCs, partnerships or closely held companies; or tangible assets like oil and gas interests, real estate, etc., valuation and justifiable discount opportunities exist to lower values and effectively freeze more of the estate through gifting. Alternatively, there are some, albeit rarer, situations where a higher value may benefit the collective family by increasing the basis of the gift and thereby lowering the future capital gains paid upon sale.

The bottom line for ultra-high net worth individuals is that the estate tax exemption and rates will likely be unfavorable in the future. The table below shows the tax savings in nominal dollars by gifting the maximum amount this year versus future years given various changes in the exemption and rate.

E&G Tax Savings at Varying Thresholds and Tax Rates							
		Exemption Amount Per Couple					
		$0	**$6,000,000**	**$10,000,000**	**$14,000,000**	**$20,000,000**	**$22,800,000**
Tax Rate	**0.0%**	$0	$0	$0	$0	$0	$0
	5.0%	$1,140,000	$840,000	$640,000	$440,000	$140,000	$0
	10.0%	$2,280,000	$1,680,000	$1,280,000	$880,000	$280,000	$0
	15.0%	$3,420,000	$2,520,000	$1,920,000	$1,320,000	$420,000	$0
	20.0%	$4,560,000	$3,360,000	$2,560,000	$1,760,000	$560,000	$0
	25.0%	$5,700,000	$4,200,000	$3,200,000	$2,200,000	$700,000	$0
	30.0%	$6,840,000	$5,040,000	$3,840,000	$2,640,000	$840,000	$0
	35.0%	$7,980,000	$5,880,000	$4,480,000	$3,080,000	$980,000	$0
	40.0%	$9,120,000	$6,720,000	$5,120,000	$3,520,000	$1,120,000	$0
	45.0%	$10,260,000	$7,560,000	$5,760,000	$3,960,000	$1,260,000	$0
	50.0%	$11,400,000	$8,400,000	$6,400,000	$4,400,000	$1,400,000	$0
	55.0%	$12,540,000	$9,240,000	$7,040,000	$4,840,000	$1,540,000	$0

While no one can predict the future of elections and taxes, there is a large risk to wealthy families that the E&G tax exemption will decrease. It's reasonable to assume that asymmetry is not on the side of the wealthy taxpayer.

Marty Hanan is the founder and President of ValueScope, Inc., a valuation and financial advisory firm that specializes in valuing assets and businesses and in helping business owners in business transactions and estate planning. Mr. Hanan is a Chartered Financial Analyst and has a B.S. Electrical Engineering from the University of Illinois and an MBA from Loyola University of Chicago.

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