Trusts & Estates

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How the New Tax Bill Affects Your Personal Income Taxes

BY: ALLEN J. FALKE

The Tax Act passed in December of 2017 represents the most significant overhaul of the U.S. tax code in decades. The Act made wide-ranging changes to the tax system that will affect nearly all individuals and businesses across the nation.

Much of the discussion about the new law has focused on the expansive tax cuts for corporations, which many view to be the most dramatic change under the tax bill. However, the new law's impact on personal income taxes is arguably the more important element, given that it will touch almost every individual in the United States. Below are some highlights on how the new law could affect you personally.

Itemized Deductions

Ready to take advantage of your usual deductions? Think again. The new law has significant implications for those deciding whether to itemize deductions or take the standard deduction.

The tax bill almost doubled the standard deduction, increasing to $12,000 for single filers (up from $6,350 in 2017), $18,000 for head-of-household filers (up from $9,350 in 2017), and $24,000 for married couples filing jointly (up from $12,700 in 2017). In exchange for this increase, however, many itemized deductions have been significantly curtailed, while others were simply eliminated.

Common itemized deductions that are still available, but significantly curtailed, include deductions for state and local income and property taxes, mortgage interest, and charitable deductions.

The change to the deduction for state and local income and property taxes (SALT) is likely to have the largest impact on the amount of itemized deductions. Under previous law, there was no limitation on the SALT deduction, unless the Alternative Minimum Tax (AMT) applied. Now, the SALT deduction is capped at $10,000 per tax return. Taxes subject to this limitation are income taxes paid to state and local governments, as well as property and excise taxes assessed by state and local taxing authorities. The $10,000 cap is the same for single taxpayers and married couples filing jointly.

Home equity interest, such as with a Home Equity Line of Credit (HELOC), is no longer deductible. Mortgage interest remains deductible, but the deduction is now limited to interest on the first $750,000 for mortgages taken out after December 14, 2017. The cap under the previous law was $1,000,000. Note that there is grandfathering for refinancing of mortgages but not for HELOCs. However, indebtedness incurred to substantially improve an existing home, even though a HELOC, may be considered acquisition indebtedness rather than home equity interest and could potentially qualify for the deduction.

One deduction that was eliminated under the tax bill is the deduction for personal casualty and theft, unless the loss happens in a declared disaster zone. Previously, taxpayers were allowed to take an itemized deduction if they suffered a loss, such as a home fire, and they did not have insurance to cover the damages or the damages exceeded their insurance coverage. Victims of "Ponzi" schemes were allowed to deduct theft losses incurred as a result of the fraudulent scheme.

Miscellaneous itemized deductions subject to the 2% floor are no longer allowed. In the past, taxpayers could deduct expenses such as tax preparation fees, certain legal fees, investment management fees, unreimbursed employee business expenses, and union dues to the extent they exceeded, in the aggregate, 2% of Adjusted Gross Income (AGI).

There is one notable increased deduction under the Tax Act — the deduction for unreimbursed medical expenses — albeit only for 2017 and 2018. Previously, certain taxpayers could deduct unreimbursed medical expenses exceeding 10% of AGI. The new law lowered the threshold for this deduction to 7.5% of AGI, effective for tax years 2017 and 2018. In 2019, the threshold will return to 10% of AGI.

Charitable Contributions

The new law also has implications for charitable contribution deductibility. Charitable contributions of cash to public charities were generally subject to a 50% limitation on deductibility. This meant that any contributions exceeding 50% of the taxpayer's AGI were not allowed to be deducted in the current year, but those amounts could be carried forward, and deducted, for the next five years. The bill increased the limitation to 60% of AGI. Any contributions exceeding the 60% can still be carried forward for the next five years.

There has been much commentary that the increased standard deduction could have a chilling effect on charitable contributions. The concern is that with the standard deduction increasing and several itemized deductions being limited or eliminated, many taxpayers will no longer receive any tax benefits for charitable contributions because they will not itemize their deductions and will therefore modify their charitable giving philosophy.

Personal Exemptions

Personal exemptions are no longer allowed as deductions. Taxpayers were previously able to deduct the personal exemption amount in calculating their taxable income. The personal exemption amount for 2017 was $4,050 per individual, and taxpayers were allowed to take deductions for themselves, spouses, and any dependents.

Alimony Payments

Lastly, a taxpayer's ability to deduct alimony paid to a former spouse has been significantly modified. Previously, a spouse paying alimony was able to deduct any alimony payments from adjusted gross income. This deduction has been eliminated for those paying alimony pursuant to divorce or separation agreements executed after December 31, 2018. Agreements entered into prior to that date will not be impacted, and the spouse paying alimony can continue to take the deduction. Agreements executed prior to December 31, 2018 can be modified to incorporate this new provision, but only if both parties agree. ■

Basis Planning — The New Estate Tax Paradigm

BY: ANDREW B. O'DONNELL

For years, estate planning strategies have focused on the benefits of lifetime gifts in order to shelter future appreciation from estate tax. The benefits were even better in Massachusetts since the gift would shelter the full value of the asset from future Massachusetts estate tax, not just the appreciation. However, now that the federal estate tax exemption has increased to approximately $11,200,000 per person under the Tax Act (until 2025), income tax "basis" planning is becoming more important than planning to reduce estate taxes for most Americans.

Income tax "basis" planning — holding assets until death instead of giving them away — can be the better strategy going forward for individuals who have assets less than the applicable exemption amount of approximately $11,200,000. Although holding assets until death will subject the assets to estate tax at death, the state estate taxes due may be less than the potential capital gains tax savings realized by obtaining a "basis step-up" in the assets for capital gains tax purposes.

For example, if twenty years ago you bought Apple stock for $10 per share, the $10 represents your cost "basis" in the stock. If you decide to give all your stock, which is now worth $200 per share, to your son, your $10 cost basis carries over to your son and becomes his basis in the stock. This is known as a "carryover basis." If your son subsequently sells the stock for $300 per share, he will have to pay capital gains tax on the difference between the $300 sales price and his $10 basis in the stock.

If, however, you hold this stock until your death, your $10 basis automatically will increase to the fair market value of the stock as of the date of your death under the basis "step-up" rules. Thus, if the stock is worth $300 per share at your death and your son inherits it from you, and then immediately sells it for $300 per share, he will not have to pay any capital gains tax on the sale. If he holds the stock for a year and then sells it for $350 per share, he will only pay capital gains tax on the $50 of appreciation that occurred after he inherited it.

Retaining the stock until your death, however, means the stock will be subject to estate tax. Assuming your assets are less than the federal estate tax exemption but more than the $1,000,000 Massachusetts estate tax exemption, you will owe Massachusetts estate tax on the $300 per share date of death value of the stock. The Massachusetts estate tax rate goes up to 16% depending upon the value of your entire estate when you die.

The issue becomes whether it is better to retain an asset until your death even if it results in a Massachusetts estate tax versus giving away the assets and subjecting them to an increased capital gains tax. Long-term capital gains tax rates are up to 20% federal, 5.1% Massachusetts, and are also subject to the 3.8% Obamacare surcharge tax. So which is better? The answer depends upon two factors: how much appreciation is built into the asset and the size of your estate.

If your cost basis in your $300 stock is $200, the potential capital gains tax savings from obtaining a basis step-up will be much lower than if your cost basis was $10. In both of these cases the estate tax cost of retaining the stock will be based on the same $300 date of death value.

In addition, remember that the cost of obtaining a basis step-up for capital gains tax purposes will be a Massachusetts estate tax due within nine months of death. The capital gains tax savings obtained from the basis step-up will only be realized if and when the asset is eventually sold, which could potentially occur many years down the road.

If you are married and your U.S. citizen spouse survives you, no Massachusetts estate tax will be due at your death, assuming you leave the assets to your spouse either outright or in certain types of trusts. With the estate taxes deferred until your spouse's later death, there will not be an immediate estate tax cost to obtaining the basis step-up, and your spouse can then gift the asset to your heirs to shelter the asset from Massachusetts estate tax after obtaining the basis step-up.

Making an informed choice has the potential for significant tax savings. ■

Estate Planning for Older Couples

BY: ARTHUR P. BERGERON AND JANET W. MOORE

The laws and government programs affecting older couples have changed over the years. But despite these changes, the goals of many of these couples remain the same. Couples want to maintain their independence and control over their lives and their assets. They want to minimize their taxes and maximize their government benefits to the greatest extent legally possible. And after they die, couples want their remaining assets to go to their children, other loved ones, or to the causes or institutions they believe important.

These couples also share concerns. People are living longer. As a result, they worry more about Alzheimer's and other diseases that can result in incapacity. The cost of caring for people with these diseases, and especially the cost of nursing home care, has skyrocketed. In 1990, it cost about $40,000 to stay in a quality nursing home for a year. Now it can cost $140,000 per year or more. In addition, Massachusetts has one of the lowest thresholds for state estate taxes in the country, affecting estates in excess of $1,000,000. Given the relatively high value of Massachusetts real estate, the Massachusetts estate tax can affect many people.

As an example, a married couple, Frank and Mary, are now retired and have three grown and independent children, Peter, Paul, and Jane. Through their hard work and frugality, Frank and Mary now own a home worth $400,000, have a cottage on the Cape worth $500,000, and other assets (IRAs worth $600,000 and $300,000, respectively, and various savings accounts and stocks worth $200,000), for a total estate value of $2,000,000. Their goal is to live in their home until they die, leave the Cape cottage to their children and grandchildren to enjoy, and have the reminder of their assets divided among their children.

Frank and Mary are worried about long-term care. If one of them needs nursing home care, their assets will be diminished at the rate of about $140,000 per year. They are also concerned about the Massachusetts estate tax due after both of them have died. The Massachusetts estate tax on $2,000,000 is approximately $100,000. Fortunately for couples like Frank and Mary, there are asset protection and estate planning strategies that can substantially reduce, or possibly even eliminate, these issues.

First, there are planning strategies for nursing home costs. If Mary, for example, needs nursing home care while both she and Frank are alive, it is possible for Mary to engage in some estate planning and possibly qualify for MassHealth (the Massachusetts version of the federal Medicaid program).

However, if Frank has predeceased Mary and she owns all of the assets and needs to go into a nursing home, Mary would then have to pay the full nursing home bill, or if possible, qualify for MassHealth with her estate having to reimburse MassHealth following her death. Either situation would substantially reduce the amount that would be left as an inheritance for their children.

Frank and Mary can take steps to address these issues. Frank can execute a will specifying that all his assets will be held in trust for Mary (Peter, Paul and/or Jane could be the trustees). Under this plan, any assets in the trust for Mary would be non-countable in qualifying Mary for MassHealth and non-recoverable by MassHealth following Mary's subsequent death. These assets could be used to supplement Mary's care during her lifetime, and the remaining assets would go to the children after Mary's death.

Frank's will can also minimize the Massachusetts estate tax. There is no estate tax in Massachusetts on estates of less than $1,000,000. If Frank specifies in his will that up to $1,000,000 of his assets would not pass to Mary directly but would instead be held in trust for Mary's benefit (and/or their children), those assets will not be included in Mary's taxable estate when she dies. If Mary's estate is $1,000,000 or less when she dies, all of Frank and Mary's assets will pass to their children estate-tax free.

Your situation may differ from Frank and Mary's. But if you (and your spouse) share their worries and concerns, you should consider planning now by adjusting your estate plan to take into account future nursing home bills and estate taxes. ■

Should You Still Be Concerned about Estate Taxes

BY TRACY A. CRAIG

With the passage of the Tax Act at the end of 2017, the federal estate, gift, and generation-skipping tax exemptions doubled to $11,180,000 per person. Married couples who are U.S. citizens can now pass over $22,000,000 to anyone free of federal estate tax. In addition, this exemption amount continues to be indexed for inflation (although at a slightly reduced rate), so the exemption will increase slightly each year.

With these changes, approximately 99.9% of all U.S. citizens and residents no longer need to worry about the federal estate, gift, and generation skipping transfer taxes. However, the increases in the exemption amounts under the new law are currently scheduled to sunset at the end of 2025, along with many other provisions of the Tax Act.

While federal estate taxes are no longer a concern for most, twelve states, including Massachusetts, and the District of Columbia still have a state estate tax; six states have an inheritance tax in some form. State estate and inheritance taxes apply to individuals domiciled in that state and to people who own real property or have registered tangible personal property (such as cars, boats, and airplanes) in that state.

Here is a list of states with estate and inheritances taxes:

STATE	EXEMPTION AMOUNT
Connecticut	$2,600,000 in 2018 $3,600,000 in 2019 Equal to federal exemption in 2020
District of Columbia	$11,180,000
Hawaii	$11,180,000
Illinois	$4,000,000
Iowa	No estate tax Has separate inheritance tax
Kentucky	No estate tax Has separate inheritance tax
Maine	$11,180,000
Maryland	$4,000,000 in 2018 Equal to federal exemption in 2019 Also has inheritance tax
Massachusetts	$1,000,000 (threshold)
Minnesota	$2,400,000 in 2018 $2,700,000 in 2019 $3,000,000 for 2020 and thereafter
Nebraska	No estate tax Has separate county inheritance tax
New Jersey	No estate tax Has separate inheritance tax
New York	$5,250,000 in 2018 Equal to federal exemption in 2019
Oregon	$1,000,000
Pennsylvania	No estate tax Has separate inheritance tax
Rhode Island	$1,537,656 in 2018 (indexed for inflation)
Vermont	$2,750,000
Washington	$2,193,000 (indexed for inflation)

For those clients who will likely be subject to a state estate tax or inheritance tax, there is good news: Estate planning can reduce or minimize these state taxes. Techniques such as credit shelter trusts, changing domicile, lifetime gifting of property, and possibly changing the ownership of structure of real estate can all lessen the burden of looming state estate taxes and inheritance taxes.

While the likelihood of being subject to the federal estate tax in the next several years has decreased substantially, clients living in states with state estate and inheritance taxes should consider implementing an estate plan to help alleviate some of these potential tax concerns. ■

Taking Advantage of Changes to 529 Plans and ABLE Accounts under the New Tax Act

BY: TRACY A. CRAIG AND EMILY L. CRIM

The Tax Cut and Jobs Act of 2017 made several changes to 529 Plans and ABLE Accounts. These changes provide important benefits that have the potential to help many families.

A 529 Plan is a tax-favored way to save for a child's education. 529 Plans allow individuals to contribute cash to be invested within the Plan, and have it grow tax-free. All contributions to a 529 Plan are considered gifts to the named beneficiary and qualify for the $15,000 per donee annual gift tax exclusion or use part of the contributor's lifetime gift tax exemption (currently $11,180,000).

Once funds are invested in the 529 Plan, the investments grow tax-free. As long as the funds are used to pay for a beneficiary's qualified educational expenses, no income taxes on the investments are ever paid. If funds are taken out of the 529 Plan for purposes other than qualified educational expenses, the investment growth will be taxed at ordinary income tax rates with an additional 10% penalty fee.

The Tax Act expanded the definition of qualified educational expenses to include up to $10,000 per beneficiary per year to pay for primary and secondary school (K-12) tuition at private, public, or religious schools. Prior to this change, qualified educational expenses only included post-secondary school, such as colleges, technical schools, or graduate schools.

In addition, Massachusetts residents who contribute to a Massachusetts 529 Plan — the U.Fund (offered through Fidelity Investments) — can now claim a Massachusetts state income tax deduction. Single persons can claim a deduction up to $1,000, and married persons filing jointly can claim up to $2,000. This deduction is currently scheduled to expire in 2021.

The Tax Act also includes changes to ABLE (Achieving a Better Life Experience) Accounts. Like 529 Plans, ABLE Accounts are tax-advantaged savings accounts. However, ABLE Accounts are designed to help individuals with disabilities, and their families, set aside funds to pay for disability-related expenses without risking eligibility for government benefits, such as Medicaid or Supplemental Security Income (SSI). ABLE Accounts can only be set up for individuals whose disabilities began prior to age 26.

ABLE Accounts are similar to 529 Plans, with tax-free growth as well as tax-free withdrawals, so long as account funds are used to pay for qualified expenses. In addition to education costs covered under 529 Plans, qualified disability-related expenses include housing, transportation, health, employment training, and financial management expenses.

As of 2018, anyone — including a beneficiary — can contribute up to $15,000 per year (up from $14,000 last year) to an ABLE Account. So long as assets in an ABLE Account are $100,000 or less, an otherwise eligible beneficiary will maintain eligibility for government benefits.

The changes enacted by the Tax Act allow beneficiaries of ABLE Accounts who are employed and earning income to go over the $15,000 annual cap and contribute up to the federal poverty level, which is currently $12,140 for a single individual. As a result, working ABLE Account beneficiaries can potentially make contributions of as much as $27,140 per year to the Account.

The most significant change under the Tax Act is the ability to roll over funds tax-free from 529 Plans to ABLE Accounts. Many families open 529 Plans to begin saving for a child's education expenses. However, after the child is diagnosed with a disability, these families may decide that the saved funds would be better used toward disability-related expenses. Prior to the Tax Act, families wishing to transfer funds from a 529 Plan to an ABLE Account faced penalties and additional taxes due to withdrawing the funds from the 529 Plan for non-educational purposes. Now, so long as the ABLE Account beneficiary and 529 Plan beneficiary are the same person or in the same family, families can make tax-free rollovers of up to $15,000 to the ABLE Account. ■

ABOUT US

Attorneys in the Mirick O'Connell Trusts and Estates Group counsel individuals and families in all matters concerning estate, gift, charitable and fiduciary income tax planning, elder law and special needs planning, and asset protection and Medicaid planning.

Our attorneys have extensive experience in drafting sophisticated estate planning documents and implementing wealth planning strategies. The integration of our experienced trusts and estates lawyers with our skillful litigation and trial lawyers enables us to provide sound legal advice and creative dispute resolution strategies.

Mirick O'Connell has been growing and evolving for over 100 years. An enduring strength of our firm is a collegial and respectful work environment where individuals with a variety of backgrounds, perspectives, and life experiences come together to provide outstanding legal services.

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