GUNSTER
PRIVATE WEALTH SERVICES

Gunster Private Wealth Services
2018 Year End Update Letter

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Midterm Elections: High Turn Out, Low Certainty

While Floridians anxiously await the final certification of the results of Florida's three highest profile contests, the overall results are a bit more definitive on the federal level. Democrats now make up the majority of the House of Representatives while the Republicans appear to continue to hold a narrow majority in the Senate. A divided Congress traditionally means that new laws come dearly. Since tax legislation originates in the House, this will be especially true for extending or making permanent some of the changes under the Tax Cuts and Jobs Act (the "New Tax Act"). No new tax reduction legislation is likely to be introduced by the House and the Senate will almost certainly block any legislation that will have the effect of increasing taxes.

2019 Estate, Gift and GST Tax Exemption and Exclusion Levels

Making gifts of appreciating or income producing property to younger, lower income generations can be a fruitful tax savings strategy because those younger generations often have a lower effective tax bracket and all post-gift appreciation accrues outside of the donor's gross estate (i.e., estate tax base). When making lifetime gifts, it is important to consider the tax exemptions and exclusions that are currently available. As a result of the New Tax Act, the lifetime gift (and estate) tax exclusion amount and the generation skipping transfer (GST) tax exemption amount is $11,180,000 for 2018. It is anticipated that the estate, gift and GST tax exemptions will increase in 2019 to approximately $11,400,000. While a $220,000 increase does not sounds like much when compared to the increases of the last few years, if leveraged gifting and estate freezing strategies are used that $220,000 can end up saving quite a bit more in eventual estate tax.

The "annual exclusion" gift amount for 2018 is $15,000 and this amount should remain static for 2019. If you are planning on making an annual exclusion gift to an account for a minor, there is more reason than ever to consider a 529 Plan. Under the New Tax Act, you can now spend up to $10,000 per year from a 529 Plan for tuition at elementary or secondary public, private or parochial schools without regard to the already allowed distributions available for college education expenses.

Although an unlimited marital deduction is generally allowed for gifts to spouses, the marital deduction is not allowed for gifts made to spouses who are not U.S. citizens. However, the annual exclusion for gifts to non-citizen spouses is $152,000 in 2018 (increasing to an estimated $155,000 in 2019) for gifts that would otherwise qualify for the gift tax marital deduction. (Estimates courtesy of Thompson Reuters)

Business Owners: Get the Most Out of the Qualified Business Income Deduction While You Can

One of the most talked about changes coming from the New Tax Act is the deduction for qualified business income. The discussion has involved how significant the new deduction could be for closely held business owners and also how many parts of the new law required clarification. In very basic terms, you can receive a deduction against federal income equal to up to 20% of your US business income received from partnerships, Subchapter S corporations, or even single member LLCs for all tax years beginning before Dec. 31, 2025. What is so unusual is that the deduction is generally available simply because your qualified business income "flows-through" to your income tax return.

There are some limitations, however, which suggest an overall goal of encouraging the hiring of

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employees and making large capital asset acquisitions. Among those limitations is the phased-in disqualification of income earned by most professionals, performing artists, athletes, consultants, and financial advisors from being considered qualified business income once their taxable income exceeds $157,500 (or $315,000 in the case of married filing jointly).

Another limitation that applies to qualified business income above certain levels becomes dependent on two factors within "flow-through" businesses. These factors are the amount of W-2 wages paid by the business and the acquisition basis of depreciable tangible property used in the business. Ultimately, if your taxable income is over $207,500 (if single) or $415,000 (if married), your deduction for qualified business income cannot exceed the greater of: (1) 50% of your allocable share of the W-2 wages paid with respect to the qualified trade or business, or (2) the sum of 25% of such wages plus 2.5% of the unadjusted basis immediately after acquisition of tangible depreciable property used in the business (e.g., real estate).

We have helped clients take steps to maximize their qualified business deduction. There has been a fair amount of caution, however, and some clients have not taken steps that could potentially be beneficial because of some of the lack of clarity provided by the new law.

In August of this year the IRS did attempt to provide some clarity on a few matters through proposed regulations. While far from the final say on the law, those proposed regulations were widely regarded as taxpayer unfriendly, in particular for professionals. For the most part though, these proposed regulations do not eliminate planning options (except perhaps for professionals) but make those options more of an effort. It could be a costly mistake to not explore whether you should take steps to maximize this new deduction while it lasts.

While the Federal Estate Tax Exemption Jumps, Many State Level Exemptions Remain Grounded

Sixteen states and the District of Columbia have either an estate or inheritance tax. For a number of years, several of the states with their own state level estate tax have maintained a policy of aligning their estate tax laws with the federal laws. This allows a certain level of administrative simplicity and piggybacking of federal level rulings and interpretations. Times - they are a chang'n, however. Over the last year or so, a number of states with estate tax exemptions tethered to federal law have decided that they can't afford to follow where the federal exemptions are going. It appears that states were ready for an estate tax exemption equal to $5,600,000 but it seems that $11,180,000 was a bridge too far.

Just two months prior to the New Tax Act, Connecticut decided to phase in its estate and gift tax exemption to match the federal exemption by 2020. Then, in June of this year, after seeing potential exemption levels well above what was anticipated last year, pushed the synchronization out to 2023. Likewise, the District of Columbia started 2018 with an estate tax exemption tied to the federal exemption but in June retroactively changed the exemption level back to $5,600,000 with inflation indexing for future years.

Hawaii amended its estate tax laws to match the federal estate, gift and GST tax exemptions that existed immediately prior to the enactment of the new tax law. This made its estate tax exemption $5,600,000 for 2018. Similarly, Maine tied its estate tax exemption to federal law as of December 31, 2017. As with Hawaii, Maine's estate tax exemption for 2018 will be $5,600,000 and grow with inflation from there.

For 2018, the estate tax exemption in Maryland has been $4,000,000. Its exemption level was scheduled to match the federal estate tax exemption amount in 2019, but Maryland recently implemented changes to limit the Maryland estate tax exclusion to $5 million in 2019 and for the foreseeable future.

Of course, not all states are specifically reacting to the recent changes in federal law. While Delaware and New Jersey actually repealed its estate tax effective this year and New York's exemption will match the federal exemption level next year, Massachusetts and Oregon still have an estate tax with only a $1,000,000 exemption allowed.

These new steps by the states are a good reminder that governments that can't print their own money can't always march to the same drum beat as those that can. We are fortunate that Florida does not have an estate tax but if you have real estate or tangible personal property in

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certain other states (District of Columbia, Connecticut, Hawaii, Illinois, Iowa, Kentucky, Maine, Maryland, Massachusetts, Minnesota, Nebraska, New York, Oregon, Pennsylvania, Rhode Island, Vermont, and Washington), make sure to give those assets special attention. This is especially important because most of these states impose the estate tax on real estate and tangible personal property located in these states, even if the decedent is not a resident of that state. In some of these states there are ways to avoid the imposition of such tax and we have assisted clients in doing so.

The IRS is Not Amused by State Legislatures' SALT Limitation Avoidance Tactics

Starting this year, individuals are limited to deducting up to only $10,000 of state and local taxes (SALT) paid against their federal income tax. To many people this change was obvious political retribution against high tax "blue" states but to others the change was a long overdue elimination of the subsidization of those same states' budgets. Regardless of your view of the limitation, the significant increase in the standard federal income tax deduction means that the SALT limitations affect a relatively small percentage of taxpayers – about 5% according to the IRS. This has not stopped the legislatures in states like New York, New Jersey, Massachusetts and California from considering, or at least loudly discussing, ways to counteract the SALT limitations.

One of the tactics considered has been creating a charity whose purpose is to support the state. As an alternative to paying state income taxes, taxpayers could make "donations" to the charity and receive a state level income tax credit (essentially a dollar for dollar deduction) in return. The strategy behind payments to state charities is that the state gets its revenue to use and the taxpayer gets a federal income tax charitable contribution deduction that is not subject to the SALT limitation.

In August of this year, however, the IRS checked this potential move by the states by publishing proposed regulations that reduce a taxpayer's charitable contribution deduction by the amount of any state or local tax credit received by making a contribution to a state charity. Such a reaction by the IRS was predictable. The IRS is tasked with collecting revenue in any circumstance. In this situation, it is necessary for the IRS to make sure the SALT limitation has teeth in order to offset all of the tax cuts in the new tax law.

You would predict the reaction by mobile, high taxpaying residents would be to move to no income tax states like Florida. This is starting to happen but that option is just not possible or palatable for every high income earner. In those cases, we have seen people contribute their taxable investments to out of state irrevocable trusts that have an independent income tax existence in order to reduce state level income tax liability. Of course, that solution is far from perfect. One thing that is certain is that this game of cat and mouse is definitely not over.

Qualified Opportunity Zone Investments are Given Significant Tax Preferences

With the new tax act, Congress has attempted to create a potent incentive to invest in economically disadvantaged census tracts referred to as "opportunity zones." The inducements are significant. If you invest cash in a Qualified Opportunity Fund and hold the investment for 10 years, the gains from the sale or liquidation of such property will be excluded from federal income tax. Additionally, if you sold appreciated property in order to generate the cash and invested in the Qualified Opportunity Fund within 180 days of the prior sale, you can defer paying tax on the gain from the sale of such appreciated property until the earlier of the date the Qualified Opportunity Fund investment is sold or 2026. If that is not incentive enough, if you hold the Qualified Opportunity Fund investment for 5 years, your basis in the investment is increased by 10%, and if the Qualified Opportunity Fund investment is held for 7 years, your investment will receive an additional 5% basis. Thus, if you sell a property for an $800,000 gain in 2019 and reinvest all of the $800,000 gain in Qualified Opportunity Fund within 180 days, you do not have to include the $800,000 in gross income in 2019. If you hold the investment for at least 5 years, your basis in the new investment will increase by $80,000 (10% of the gain originally deferred) thereby decreasing the amount of gain eventually recognized. If you hold

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the investment for at least 7 years, your basis in the new investment will increase by another $40,000. While you will need to recognize deferred gain (minus the accumulated 15% reduction in gain) in that same year, 2026, if you eventually sell the property in 2030, you can exclude all remaining gain.

So how do you invest in a Qualified Opportunity Fund? It can be very confusing. Actually, you will invest cash in the equity of a corporation, partnership or LLC taxed as a corporation or partnership that files the proper self-certification and invests 90% of its assets in either a Qualified Opportunity Zone Business or another corporation, partnership or LLC that conducts a Qualified Opportunity Zone Business. A Qualified Opportunity Zone Business is essentially a business in which substantially all of its owned or leased real estate and equipment is Qualified Opportunity Zone Business Property. There are a few technical requirements for Qualified Opportunity Zone Business Property, but it is essentially property used in a business that is in one of the now established "opportunity zones" which can be found at www.cdfifund.gov.

If you are seeking a long term investment in a business or real estate, Qualified Opportunity Funds represent a very interesting new opportunity to accentuate return through very preferential tax treatment.

Significant Changes to the Taxation of Alimony

The award of alimony is a very common result in a divorce that requires a spouse with greater financial resources to support a former spouse. In Florida, alimony is often granted to be rehabilitative but it can also be durational or permanent. Traditionally, the receipt of alimony is included in income and the payment of alimony is income tax deductible. However, alimony paid in connection with a divorce agreement executed (or potentially modified) after December 31, 2018 will no longer be deductible and alimony received will no longer be subject to income tax. That is a very big change in the economics of divorce. The laws and customs involving divorce have relied on the same tax treatment of alimony for the last seven decades and the whole area of the divorce law will need to react quickly to avoid terrible results.

This new provision is not tax neutral. Even with shifts in the amounts of alimony awarded, the new law should still create more overall tax. If an individual who earns $235,000 of income in a year gets divorced in 2019 and pays $40,000 of alimony to an ex-spouse who earns $90,000 per year, there will be more overall tax liability than there would have been under the old alimony law. Pre-2019 divorce alimony has the effect of shifting taxable income from the higher income spouse with a higher effective tax bracket to the lower income spouse with the correspondingly lower effective tax bracket. The shift of liability will no longer happen and there will be fewer resources to spread between the ex-spouses.

New Opportunity to Rescue Trusts with Unfortunate Terms

There are plenty of compelling reasons to execute and fund irrevocable trusts. The downside, however, is that once a trust is irrevocable, the grantor is not generally able to change the terms of a trust. Many irrevocable trusts appoint successor trustees who are appropriate at the time of execution but years later the appointment makes very little sense. It might also surprise you that, every once in a while; someone wants to get rid of one of the trust beneficiaries or extend the time for when trust assets are distributed outright to a beneficiary. Occasionally a do over is desired. This is where trust decanting comes into play. Decanting is a legal process which allows the trustees to distribute trust property from one trust, presumably with one or more undesirable terms, to another trust with presumably more desirable terms.

The old trust and the new trust do have to share some similarities, the most important of which is that you can't add new beneficiaries. Also, you must be mindful of the distribution terms. Prior to July of this year, trust decanting in Florida was limited to trusts with full discretionary distribution powers. In other words, you could not decant from a trust where the trust distribution powers were limited to the ascertainable standard of health, education, maintenance and support. While trust decanting is not the only option for changing the terms by which assets are held, the old law was quite limiting because many trusts provide exclusively for distributions based on a health, education, maintenance and support standard. In July of this year, however, Florida law changed to allow the decanting of a trust even if the distribution terms are limited to health, education, maintenance and support.

If you are involved in an irrevocable trust and there are outdated, undesirable provisions now may be the time to consider using the decanting process.

Battle Over States' Right to Tax Trusts Ongoing Across US

For a variety of reasons, including warm weather and low taxes, Florida attracts people who have lived a significant portion of their lives elsewhere. As a result, it is common for the trustees and beneficiaries named in estate plans to live in other states, often multiple other states. Considering the residence of trustees and beneficiaries has gotten more important in estate planning over the years as state budgets have gotten tighter and state tax laws, particularly the enforcement of those laws, has gotten more aggressive. While Florida does not have an individual or trust income tax, many states are attempting to tax irrevocable trusts which share some connection, however thin, to those states. Taxpaying trusts though are in some cases convincing courts that those attempts are out of bounds.

One of the tactics is the taxation of a trust simply because the grantor was a resident of the state when the trust was created. This tactic has resulted in some losses in court for the states lately. Most recently, the Minnesota Supreme Court agreed it was against no less than the due process clauses for the U.S. and Minnesota Constitutions, as well as the commerce clause of the U.S. Constitution, to apply Minnesota tax to non-Minnesota income merely because the trust became irrevocable while the grantor was a Minnesota resident. The Minnesota Supreme Court did not believe that residence of the grantor was enough to satisfy the "sufficient contacts" requirements implicit in the due process clauses. This case follows a North Carolina Supreme Court case that held that North Carolina did not have the minimum contacts necessary to tax a trust when the only connection to North Carolina was the residency of one or more of the trust's beneficiaries.

The victories in this area, however, are not all one way. Massachusetts law provides that Massachusetts may tax any trust in which at least one grantor, one beneficiary and one trustee are inhabitants of the commonwealth. The Supreme Judicial Court of Massachusetts recently held that trusts created in Massachusetts with a national bank as trustee were treated as having a trustee who was an inhabitant because that national bank conducted business in Massachusetts. As a result, Massachusetts could impose tax on those trusts despite the fact that they had no Massachusetts based income.

Further, the Ohio Supreme Court upheld a lower court ruling last year that Ohio could impose income tax on the gain from the sale of an Ohio Subchapter S corporation's stock despite the fact that the only connections the trust had to Ohio was that the grantor was a resident on the date of the trusts creation. With no trustees or beneficiaries located in Ohio, those are pretty minimal contacts with Ohio.

Estate Plan Review and Monitoring Changes in the Law

We recommend that you review your estate plan periodically to ensure it is updated taking into account your current family situation, your current asset structure, your dispositive wishes, tax provisions currently in effect, and your trustee selections. Each of these aspects of your plan necessarily changes over time. The New Tax Act has granted us a variety of new opportunities but some of those planning opportunities have a limited shelf-life. Now is the time to take advantage of such opportunities. You should also check to make sure that your assets are properly titled, and beneficiary designations for insurance, retirement plan and annuities are properly completed, so that your estate plan operates as intended.

We hope the information in this letter is helpful to you as 2018 winds to a close. If you have any questions, we would be happy to assist you. Best wishes for a healthy and joyous holiday and New Year.

In this Year-End Update Letter, we have deliberately simplified technical aspects of the law in the interest of clear communication. Under no circumstances should you or your advisors rely solely on the contents of this Year-End Update Letter for legal advice, nor should you reach any decisions with respect to your personal tax or estate planning without further discussion and consultation with your advisors.