# THE ESTATE PLANNER

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Allman Spry

ATTORNEYS AT LAW

**ALLMAN SPRY DAVIS LEGGETT & CRUMPLER, P.A.**

380 KNOLLWOOD STREET, SUITE 700
WINSTON-SALEM, NORTH CAROLINA 27103-4152

TELEPHONE: (336) 722-2300

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# The Tax Cuts and Jobs Act boosts exemption amounts

With the passage of the Tax Cuts and Jobs Act (TCJA), the estate planning landscape hasn't changed as drastically as some lawmakers would have liked. While the TCJA temporarily doubles the combined gift and estate tax exemption and the generation-skipping transfer (GST) tax exemption, it doesn't outright repeal the estate tax, as envisioned in the U.S. House of Representatives' version of the bill.

Nevertheless, changes in the TCJA create new estate planning opportunities and challenges that merit a review of your plan.

## What's new?

For the estates of persons dying, and gifts made, after December 31, 2017, and before January 1, 2026, the gift and estate tax exemption and the GST tax exemption amounts increase to an inflation-adjusted $10 million, or $20 million for married couples with proper planning (expected to be $11.2 million and $22.4 million, respectively, for 2018). However, absent further congressional action, the exemptions will revert to an inflation-adjusted $5 million and $10 million, respectively, beginning January 1, 2026.

The marginal tax rate for all three taxes remains at 40%. So to the extent these taxes do apply to a family, they will continue to be substantial.

Regarding charitable giving, which is a key element of many estate plans, the TCJA raises the adjusted gross income limitation for income tax deductions of cash donations to public charities from 50% to 60% for 2018 through 2025. But, because of the higher exemptions, charitable strategies designed to reduce gift and estate taxes may be less valuable.

## Estate planning still important

Even if your estate is well below the new exemption and the possibility of estate tax liability seems remote, estate planning is still important. For one thing, there are many nontax issues to consider, such as asset protection, guardianship of minor children, family business succession, and planning for loved ones with special needs.

In addition, it's not clear how states will respond to the federal tax law changes. If you live in a state

that imposes significant state estate taxes, many traditional tax-reduction strategies will continue to be relevant.

It's also important to keep in mind that the exemptions are scheduled to revert to their previous levels in 2026. And there's no guarantee that the exemption amounts won't be reduced even further. So implementing strategies now that can help you shield your wealth against tax changes down the road is still a good idea.

## Locking in new exemption amounts

Record-high exemption amounts, even if temporary, provide an opportunity to implement strategies that can "lock in" those exemptions and permanently avoid future transfer taxes. For example, by using some or all of the increased exemption amount to make additional tax-free lifetime gifts, you can shield that wealth — together with any future appreciation in value — from taxation in your estate, even if smaller exemptions have been reinstated when you die.

Keep in mind, though, that lifetime gifts, unlike assets transferred at death, aren't entitled to a stepped-up basis. This can increase income taxes on any gain realized by the recipients should they sell a gifted asset. So, when considering lifetime gifts, it's important to weigh the potential estate tax savings against the potential income tax costs.

## Meet with your estate planning advisor

Even though the TCJA doesn't repeal the estate tax, it can significantly affect your estate plan — in both positive and negative ways. We've covered only some of the ways here, and additional tax-saving opportunities are available, such as dynasty trusts. Contact your advisor to learn all of the details. ▮

*Foreign financial accounts*

# Don't overlook FBAR requirements

In recent years, the IRS and the Financial Crimes Enforcement Network (FinCEN) have stepped up their enforcement of foreign account reporting requirements. An important tool in this effort is FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR).

Often misunderstood or overlooked, the FBAR can be a costly trap for the unwary. It must be filed by any "U.S. person" with a financial interest in or signature authority over foreign financial accounts with an aggregate value that exceeds $10,000 *at any time* during the calendar year. U.S. persons include U.S. citizens, residents, estates, trusts and business entities.

The potential consequences of noncompliance are severe: The maximum penalty for willful failure to file an FBAR is the *greater* of $100,000 or 50% of the account balance. FBARs must be filed electronically with FinCEN by April 15 (April 17 this year), although an automatic six-month extension is available to October 15.

## What is a foreign financial account?

Financial accounts include bank accounts, securities and brokerage accounts, and other accounts maintained with a financial institution or "other person performing the services of a financial institution." They also include mutual funds, insurance and annuity funds with cash values, commodity futures or options accounts, and certain retirement accounts.

Foreign accounts are those located outside the United States, regardless of the financial institution's nationality. So, for example, an account maintained with a branch of a U.S. bank physically located outside the United States is a foreign financial account, while an account maintained with a branch of a foreign bank physically located in the United States is not.

## Who has a financial interest or signature authority?

The owner or legal titleholder of an account has a financial interest in it, regardless of whether he or she enjoys any benefits from the account. And one who uses an agent, attorney or other representative to acquire an account has a financial interest even without legal title.

Suppose, for example, that Emily, a U.S. citizen living abroad, agrees to hold $15,000 in her foreign bank account for her sister, Maxine, also a U.S. citizen. Both sisters have a financial interest in the account and must file FBARs: Emily as the legal owner, and Maxine as the beneficial owner of the funds.

One can also hold a financial interest in a foreign account through a business entity or trust. Under the FBAR rules, a U.S. person who owns, directly or indirectly, more than 50% of a corporation's voting power or total value is deemed to hold a financial interest in the corporation's foreign financial accounts. Similar rules apply to owners of more-than-50% capital or profits interests in partnerships and to majority owners of other types of entities.

Financial interests in accounts held in trust are attributed to a U.S. person who 1) has an ownership interest in a grantor trust, 2) has a *present* beneficial interest in more than 50% of the trust assets or 3) receives more than 50% of the *current* trust income. Beneficiaries are relieved of their FBAR filing obligations, however, if the trust or its trustee has a separate FBAR filing obligation.

FBAR reporting obligations also extend to U.S. persons with signature authority over foreign financial accounts. These may include power of attorney holders, officers or employees of entities that hold foreign accounts, trustees of trusts that hold foreign accounts and executors of estates that hold foreign accounts.

## Impact on estate planning

In an estate planning context, foreign account reporting obligations can arise in a variety of ways. Anytime you designate another person to act on your behalf or transfer interests in your assets to other people or entities, you may trigger additional FBAR reporting obligations. If you own or control foreign financial accounts, consult your estate planning advisor to discuss your FBAR and other reporting obligations and their potential impact on your estate plan. ▮

# Adequate disclosure

*Why you should file gift tax returns even if they're not required*

Whenever you transfer property to another person — especially a family member — consider filing a gift tax return, even if it's not technically required. Why? Because a timely filed gift tax return that meets the IRS's "adequate disclosure" requirements starts the clock on the statute of limitations.

## An unexpected tax bill

Generally, the IRS has three years to challenge the value of a transaction for gift tax purposes or to assert that a nongift was, in fact, a partial gift. But unless the transaction was adequately disclosed, there's no time limit for reviewing it and assessing additional gift tax. That means the IRS can collect unpaid gift taxes — plus penalties and interest — years or even decades later.

There's a reluctance to file gift tax returns disclosing nongift transactions for fear of drawing the IRS's attention. However, a carefully prepared gift tax return can be the best insurance against unpleasant tax surprises down the road.

Let's take a look at a fictional example: Fred, the sole owner of a closely held business, decides to sell 10% interests in the business to each of his four children. He estimates that the business is worth $10 million and, after applying a 25% minority interest discount, values each child's interest at $750,000. He transfers a 10% interest to each child in exchange for a $750,000 promissory note. Let's assume that Fred has already used up his lifetime gift and estate tax exemption.

Because Fred transfers the interests in exchange for what he believes is full and adequate consideration, he doesn't file a gift tax return. Fast-forward 10 years: The IRS determines that the actual value of the business at the time of the transfers was $15 million, so that each child's interest was

### Benefits of an independent appraisal

Generally, adequate disclosure of gift or nongift transactions requires either:

- A detailed description of the method used to determine the property's fair market value, including financial data, transfer restrictions considered and a description of any blockage, minority interest, fractional interest or marketability discounts claimed, or
- An appraisal of the property (including certain required information) by an independent, qualified appraiser. "Independent" means that the appraiser isn't the transferor, the transferee, or a relative or employee of either.

Obtaining an independent appraisal offers significant benefits, particularly for difficult-to-value property, such as interests in closely held businesses. An appraisal by a qualified appraiser helps ensure that the gift tax return contains all valuation information necessary to satisfy the adequate disclosure rules. Plus, if the appraisal is conducted at or near the time of the transfer, it will go a long way toward persuading the IRS that the original valuation of the property was accurate.

actually worth $1,125,000. The IRS assesses gift tax on $1.5 million — the difference between the value of the interests and the consideration paid. Assuming that the gift tax rate in the year of transfer was 40%, Fred receives a $600,000 gift tax bill plus penalties and 10 years of interest.

## What's adequate disclosure?

If Fred had filed a timely gift tax return meeting the adequate disclosure requirements, the IRS would have had only three years in which to challenge his valuation. To meet these requirements a return must include:

- A description of the transferred property and any consideration received,
- The identity of, and relationship between, the transferor and each transferee,
- The trust's tax identification number and a brief description of its terms (or a copy of the trust instrument) if property is transferred to a trust,

> *There's a reluctance to file gift tax returns disclosing nongift transactions for fear of drawing the IRS's attention.*

- Either a detailed description of the method used to value the transferred property or a qualified appraisal (see "Benefits of an independent appraisal" on page 5),
- A statement describing any position taken that's contrary to any proposed, temporary or final tax regulations or revenue rulings published at the time of the transfer, and
- An explanation as to why transfers reported as nongifts aren't gifts.

Additional requirements apply to transfers of interests in a corporation, partnership (including a limited liability company) or trust to a member of the transferor's family. In addition to the above, adequate disclosure requires:

- A description of the transactions, including a description of the transferred and retained interests and the methods used to value each,
- The identity of, and relationship between, the transferor, transferee, all other persons participating in the transactions, and *all parties related to the transferor holding an equity interest in any entity involved in the transaction*, and
- A detailed description (including all actuarial factors and discount rates used) of the method used to determine the amount of the gift (if any), including, for equity interests that aren't actively traded, the financial and other data used to determine value.

Financial data generally includes balance sheets and statements of net earnings, operating results, and dividends paid for each of the preceding five years.

## Gain peace of mind

If you transfer valuable business interests or other property to family members or others — either as gifts or as exchanges for valuable consideration — be sure to file a timely gift tax return that satisfies the adequate disclosure requirements. Doing so can help you support your valuation of the property (particularly if it's accompanied by a qualified independent appraisal), start the clock on the statute of limitations, and avoid unpleasant tax surprises years or even decades down the road. ∎

ESTATE PLANNING RED FLAG

## You haven't created a "road map" for your estate plan

No matter how much effort you've invested in designing your estate plan, your will, trusts and other official documents aren't enough. You should also create a "road map" — an informal letter or other document that guides your family in understanding and executing your plan and ensuring that your wishes are carried out. Your road map should include, among other things:

- A list of important contacts, including your estate planning attorney, accountant, insurance agent and financial advisors,
- The location of your will, living and other trusts, tax returns and records, powers of attorney, insurance policies, deeds, automobile titles, and other important documents,
- A personal financial statement that lists stocks, bonds, real estate, bank accounts, retirement plans, vehicles and other assets, as well as information about mortgages, credit cards, and other debts,
- An inventory of digital assets — such as email accounts, online bank and brokerage accounts, online photo galleries, digital music and book collections, and social media accounts — including login credentials or a description of arrangements made to provide your representative with access,
- Computer passwords and home security system codes,
- Safe combinations and the location of any safety deposit boxes and keys,
- The location of family heirlooms or other valuable personal property, and
- Information about funeral arrangements or burial wishes.

The road map can also be a good place to explain to your loved ones the reasoning behind certain estate planning decisions. Perhaps you're distributing your assets unequally, distributing specific assets to specific heirs or placing certain restrictions on an heir's entitlement to trust distributions. There are many good reasons for these strategies, but it's important for your family to understand your motives to avoid hurt feelings or disputes.

Finally, like other estate planning documents, your road map won't be effective unless your family knows where to find it, so it's a good idea to leave it with a trusted advisor.

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