HIGH-NET WORTH PLANNING DURING POTENTIAL TAX REFORM

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Following the recent election results, many high-net-worth clients and advisors are curious about how to best structure their financial plans and products to fit the potential future tax landscape. History has shown that tax laws will continue to change, requiring a thoughtful approach to incorporate flexibility and exit strategies into the planning solutions implemented. Top financial, legal and tax advisors will all agree that clients are best served to not procrastinate and avoid planning during uncertain times, for the cost of being wrong can have devastating effects to their family, business, and legacy.

Below is a summary of the initial tax reform proposals from President-elect Trump, planning considerations and best practices, and the history of the estate tax.

KEY ELEMENTS OF TRUMP'S TAX REFORM PROPOSALS:

INDIVIDUAL INCOME TAX PROPOSALS

- Create three ordinary income tax brackets of 12%, 25% and 33%, maintaining current capital gains tax brackets of 0%, 15% and 20%
- Increase in the standard deduction from $6,300 to $15,000 for single filers, $12,600 to $30,000 for married joint filers, and eliminate personal exemptions
- Cap itemized deductions at $100,000 for single filers and $200,000 for married joint filers
- Repeal the individual Alternative Minimum Tax (AMT) and the 3.8% Net Investment Income Tax
- Subject carried interest income to tax at ordinary income tax rates

TRANSFER TAX PROPOSALS

- Repeal of "death taxes" and replace with carryover basis treatment for appreciated property, subjecting built-in gains held until death to capital gain tax

  It is unclear whether "death taxes" includes all transfer taxes, specifically the gift tax
- Exemptions of $5 million of capital gains per decedent ($10 million per married couple)

  It is unclear whether the tax on appreciated gains would be triggered at death or upon subsequent disposition of the inherited property by the beneficiary; either way, a need for traditional estate planning prior to death as well as liquidity at or following death could remain
- Disallow an income tax deduction for contributions of appreciated assets to a private charity created by the decedent or the decedent's relatives

BUSINESS AND INTERNATIONAL TAX PROPOSALS

- Reduce corporate income tax rate from 35% to 15% for all business that want to retain profits within the business

  It is unclear whether the reduced rate would apply to all businesses or only those organized as C corporations with income from pass-through entities, such as S corporations and partnerships, remaining subject to individual tax rates
- Eliminate most corporate tax expenditures except the research and development credit
- Impose a one-time 10% deemed repatriation tax on corporate profits held offshore, ending the deferral of tax on offshore profits that are not subject to U.S. tax until actually repatriated

PLANNING CONSIDERATIONS IN LIGHT OF POTENTIAL TAX REFORM:

It should be underscored that Trump's proposals are only proposals and many pieces must fall into place before it, or aspects of it, can become law. Final legislation may look materially different if it is necessary to merge the House GOP's plan with Trump's, garner bi-partisan support to overcome the potential 10-year limitation (the Byrd Rule[1]) if passed under budget reconciliation to avoid a filibuster, or make concessions in pursuit of broader political agenda items.

That said, estate planning should focus on more than just taxes. It should focus on ensuring a one's estate is distributed pursuant to his or her overall legacy goals, both tax-related and non-tax-related, and in alignment with his or her values. Estate tax is an important consideration but is also a moving target.

Because the only certainty regarding the estate tax is its uncertainty, short-term windows of tax law changes should not thwart the ongoing implementation and maintenance of traditional estate and income tax planning strategies:

» Planning flexibility should be emphasized as should non-tax-related goals (e.g. control, privacy, philanthropy, estate equalization, creditor protection, preserving family values, children with special needs, incapacity, business succession, professional asset management, etc.).

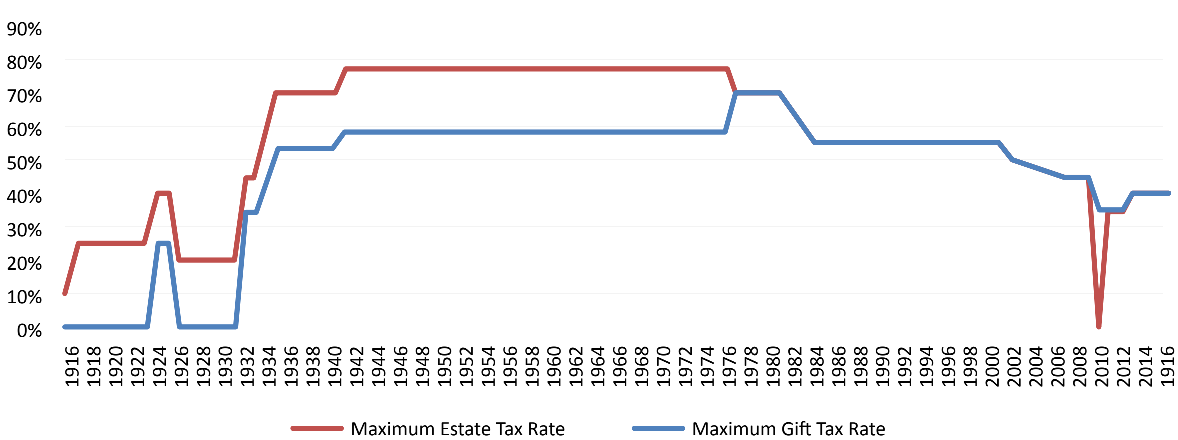
» Planning techniques that transfer or reduce estate tax liabilities have never been more favorable than today. Rarely do the time horizons of tax laws or administrations align with the mortality of a client. Clients have the highest exemption in history and proposed 2704 regulations show that certain commonly used techniques may not be available going forward and should be implemented while available.

» Life insurance is commonly used to fund estate taxes, but can be structured with flexibility and additional benefits to be viable regardless of the estate tax rates or exemptions at the time of death. Additionally, if the estate tax is swapped for a carryover basis with capital gains tax, many traditional estate planning strategies, including life insurance, could remain viable.

LOOKING BACK, THE HISTORY OF THE FEDERAL ESTATE TAX IS ONE OF CHANGE:

The estate tax laws have been enacted, repealed, or reformed 22 times since 1797, which is an average of once every 10 years. Since 1916, there have been 16 major changes, which is an average of once every six years. It may be a mistake to assume that a potential repeal in the near term would be truly permanent in nature.

Maximum Federal Estate and Gift Tax Rates, Exemptions, and Exclusions, 1916-2016



[1] The Byrd Rule is a Senate rule that amends the Congressional Budget Act of 1974 to allow Senators, during the Reconciliation Process, to block a piece of legislation if it purports to significantly increase the federal deficit beyond a ten-year term.

Table 1: History of Major Revisions to the Federal Transfer Tax Laws (1797-2016)

ENACTED 1797 The first federal estate tax was enacted to pay for a naval build-up in response to heightened tensions with France.	REPEALED 1802 Estate tax was repealed when the threat of war ended.	ENACTED 1862 Estate tax re-enacted to raise revenue for the Civil War effort.
REPEALED 1870 Estate tax repealed as the country recovered from the effects of the war.	ENACTED 1898 The third federal estate tax was enacted to finance the Spanish-American War.	REPEALED 1902 Estate tax repealed for the third time.
ENACTED 1916 Estate tax re-enacted with the advent of WWI and became a permanent feature of the tax code.	REFORMED 1930s Various changes made the basic structure of the estate tax similar to the structure of 2009.	REFORMED 1976-1993 Congress passed nine major pieces of legislation that affected the estate and gift tax taxation.
REFORMED 2001 Economic Growth and Tax Relief Reconciliation Act of 2001 provided a phase-in period of rate reductions, exemption increases, and changes in tax basis.	REPEALED 2010 Estate tax repealed for the fourth time.	ENACTED 2011 The Tax Relief, Unemployment Insurance Reauthorization & Job Creation Act of 2010 re-enacted the federal estate tax with unified gift and estate tax exemptions equal to $5 million with top marginal tax rate of 35%.
SUNSET 2013 All provisions of The TRUIRJCA 2010 scheduled to sunset on January 1st, 2013; all estate tax provisions revert to pre-EGTRRA 2001 as if both laws had never been enacted.	REVISED 2013 American Taxpayer Relief Act of 2012 was passed to avoid the sunset. $5 million estate, gift and GST exemption indexed for inflation. Top tax bracket of 40%.	

Table 2: Maximum Federal Estate and Gift Tax Rates, Exemptions and Exclusions (1916-2016)

YEAR	ESTATE TAX EXEMPTION	LIFETIME GIFT TAX EXEMPTION	ANNUAL GIFT TAX EXCLUSION	MAXIMUM ESTATE TAX RATE	MAXIMUM GIFT TAX RATE
1916	$50,000	None	None	10%	0%
1917-1923	$50,000	None	None	25%	0%
1924-1925	$50,000	$50,000	$500	40%	25%
1926-1931	$100,000	None	None	20%	0%
1932-1933	$50,000	$50,000	$5,000	45%	34%
1934	$50,000	$50,000	$5,000	60%	45%
1935-1937	$40,000	$40,000	$5,000	70%	53%
1938-1940	$40,000	$40,000	$4,000	70%	53%
1941	$40,000	$40,000	$4,000	77%	58%
1942-1976	$60,000	$30,000	$3,000	77%	58%
1977	$120,000	$120,000	$3,000	70%	70%
1978	$134,000	$134,000	$3,000	70%	70%
1979	$147,000	$147,000	$3,000	70%	70%
1980	$161,000	$161,000	$3,000	70%	70%
1981	$175,000	$175,000	$3,000	70%	70%
1982	$225,000	$225,000	$10,000	65%	65%
1983	$275,000	$275,000	$10,000	60%	60%
1984	$325,000	$325,000	$10,000	55%	55%
1985	$400,000	$400,000	$10,000	55%	55%
1986	$500,000	$500,000	$10,000	55%	55%
1987-1997	$600,000	$600,000	$10,000	55%	55%
1998	$625,000	$625,000	$10,000	55%	55%
1999	$650,000	$650,000	$10,000	55%	55%
2000-2001	$675,000	$675,000	$10,000	55%	55%
2002	$1,000,000	$1,000,000	$11,000	50%	50%
2003	$1,000,000	$1,000,000	$11,000	49%	49%
2004	$1,500,000	$1,000,000	$11,000	48%	48%
2005	$1,500,000	$1,000,000	$11,000	47%	47%
2006	$2,000,000	$1,000,000	$12,000	46%	46%
2007-2008	$2,000,000	$1,000,000	$12,000	45%	45%
2009	$3,500,000	$1,000,000	$13,000	45%	45%
2010	$5,000,000	$1,000,000	$13,000	0%	35%
2011	$5,000,000	$5,000,000	$13,000	35%	35%
2012	$5,120,000	$5,120,000	$13,000	35%	35%
2013	$5,250,000	$5,250,000	$14,000	40%	40%
2014	$5,340,000	$5,340,000	$14,000	40%	40%
2015	$5,430,000	$5,430,000	$14,000	40%	40%
2016	$5,450,000	$5,450,000	$14,000	40%	40%

Source: Internal Revenue Service, CCH Inc.; Julie Garber's "Annual Exclusion from Gift Taxes, 1997-2010," "Federal Estate, Gift and GST Tax Rates and Exemptions," McDermott Will and Emery