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2018 essential tax and wealth planning guide

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Welcome

Dear Reader,

In today's divisive political and legislative environment, especially given the ongoing prospect of US tax reform, it may be easy to surrender to inaction. Yet, in reality, this is a great time to take a fresh look at the familiar and constant aspects of your world—your family, your business, and your personal goals—to understand what in the world is changing and how you can stay out in front of it. Planning is an important part of this process, as is ongoing dialogue between you, your family members, and your tax advisers.

To help jump-start and sustain your planning, you will receive Deloitte's 2018 essential tax and wealth planning guide in a series of releases over the next few months. Each new release will provide you with information that's timely, accessible, and relevant, and will give you the chance to look again at important issues in a thoughtful, proactive, and efficient manner.

This first edition presents chapters on **individual income tax planning**, **foundational wealth transfer planning**, and **philanthropic planning**. These sections offer valuable insights on important tax issues that have emerged in 2017 and are likely to impact your year-end planning. Year end is a perfect time to look back at the calendar year and decide if you have accomplished all you intended and take advantage of any last-minute tax planning.

The second edition, coming to you just after the New Year in early January, will offer insights on **family offices**, **post-mortem considerations**, and **advanced wealth transfer planning**. These areas become more complex each year. Reflecting on potential challenges and opportunities now that could emerge in 2018 can give you ample time to prepare appropriate actions. This January release will provide you with insights on planning tools and new perspectives to take action.

The final edition, to be issued in February, will include chapters on **globalization, unique investments**, and the **tax implications of fund investing**. Understanding the tax implications of investments in the United States and other countries can help you better quantify potential after-tax investment returns. These sections will reinforce your long-term perspective even as you shape and refine your strategies over time.

A new feature in the 2018 guide is a **tax policy update**, a bonus section in each release devoted to the unfolding story of tax reform in the United States and the impact it might have on your personal situation. As this potential reset transforms the tax landscape, we'll provide you with insights to help you look again at your tax planning and decision making. Also, be prepared to revisit each release for additional hot topics in snapshots that provide relevant, timely, and actionable nuggets of information.

The **2018 essential tax and wealth planning guide** is designed to help you develop a new perspective on the familiar parts of your life and plan for whatever comes in 2018 and beyond. You can be more knowledgeable and prepared for making tax decisions over the next year by reviewing this steady stream of timely, pertinent, and easily digestible information.

To find a member of the Deloitte Private Wealth practice who specializes in your area of interest, please contact us at PrivateWealth@deloitte.com.

Regards,

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Contents

Individual income tax planning

With the potential for tax reform on the horizon, your peripheral view may include glimpses of changes in individual income tax rates or deductions. However, as you consider individual income tax planning matters, your current goals and objectives need to be front and center. Do not let the potential for tax reform distract you from what is in plain view, because those distractions may turn out to be very costly.

Now is the time for you to take another look at tax planning for your 2017 and 2018 individual tax matters. Concentrate your view on planning that is available to you today, based on current law, with an eye toward what issues and opportunities tax reform may create for you tomorrow. This will lead you down the path to realizing a more tax-efficient result for you and your family.

Today's increased tax rate environment

There are three lenses through which we can look again at individual income tax planning. First, we can examine how today's increased tax rate environment came to be. This gives perspective on how rates have differed for various types of income over the years. Then we can examine the current tax environment and how you can plan for potential income recognition or timing of controllable deductions. Finally, we can examine possibilities for tax reform and how that may reframe the picture of tax planning.

It has been said that the tax tail should not wag the dog. What that means is that though our tax rate structure has evolved over the past two decades, your investment and financial goals should remain front and center to create the best view for your tax planning. Within that view though, there are certain planning opportunities that are unique to the current tax environment and should not be overlooked due to the potential for tax reform. The potential for reform should not paralyze planning, but should compel it. Failing to acknowledge potential tax issues means that you could have a less efficient tax result. As the potential for tax reform evolves, what you truly need to understand are the planning options that exist based on your unique overall financial view.

Increased individual income tax rate environment: Look again at how we got here

As you will see in the following chart, significant changes to individual income tax rates have occurred in a relatively short period of time. This has included both increasing tax rates for ordinary income and capital gains, along with adjusting the phaseout of itemized deductions. Each shift has affected the options available for planning. At times, it may also have shifted your financial objectives by examining the income or deductions to which a particular investment may give rise. Therefore, we will briefly explain how the existing increased individual income tax rate environment came to be.

Today's increased tax rate environment

2013
Patient Protection and Affordable Care Act (PPACA) passed 2010, effective 2013

- While passed in 2010, the PPACA imposed the following taxes, effective as of January 1, 2013, for taxpayers with adjusted gross income (AGI) over the applicable threshold ($200,000 for single filers)/$250,000 for married filing joint):
  - 3.8 percent net investment income tax (NIIT) on the net investment income of individuals, estates, and trusts
  - 0.9 percent increase (from 1.45 percent to 2.35 percent) on the employee share of Medicare taxes imposed on earned income by the Federal Insurance Contributions Act Hospital Insurance (FICA-HI)

2012
American Taxpayer Relief Act of 2012 (ATRA)

- Permanently extended the reduced tax rates for lower- and middle-income taxpayers, but allowed the top tax rates to increase and return to pre-EGTRRA levels for upper-income taxpayers
- Permanently increased the top rate on income from capital gains and qualified dividends to 20 percent
- Permanently extended the limitation on itemized deductions, commonly known as the Pease limitation and the personal exemption phaseout (PEP), for single taxpayers with AGI over $250,000, or $300,000 for married filing jointly (MFJ) filers
- Permanently indexed the alternative minimum tax (AMT) exemption amount to inflation to eliminate the needs for an annual patch

2010
Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRUIRJCA)

- Extended the fully phased-in EGTRRA rate reductions and repealed the Pease and PEP limitations for two additional years, through 2012
- Extended the JGTRRA changes with respect to capital gain and dividend income for two additional years

2003
Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA)

- Accelerated certain tax changes passed under EGTRRA
- Lowered from tax rate on dividends and capital gains
- Increased the exemption amount for the individual AMT

2001
Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)

- Phased in a reduction in ordinary and capital gains tax rates over nine years
- Phased out the Pease limitation and PEP
- Created the concept of qualified dividends with a preferential tax rate
- Sunset provision of EGTRRA meant as of January 1, 2011, everything would revert back to pre-EGTRRA levels

Look again at current tax rates by type of income

Now that we have briefly examined how the current increased income tax environment came to be, we will discuss the various rate components based on the type of income being taxed.

Categories of income
Ordinary income
Qualified dividends
Capital gains

Categories of tax
Income tax
Self-employment
Alternative minimum tax (AMT)
Health care taxes
State and foreign taxes

Ordinary income tax rates

If your primary source of income comes from employment, then you will generate ordinary income in the form of wages, salaries, tips, commissions, bonuses, and other types of compensation. Other investments may also generate ordinary income in the form of interest, nonqualified dividends, net income from a sole proprietorship, partnership or limited liability company (LLC), rents, royalties, or gambling winnings. For 2017 (and 2018), the top marginal ordinary income tax rate is 39.6 percent for single taxpayers with income more than $418,400 ($426,700) and married taxpayers with income more than $470,700 ($480,050). Ordinary tax rates continue to range from 10 percent to 39.6 percent and will remain in place permanently until further reform.

Tax rates on qualified dividends

We will refer to qualified dividend income as tax preferential income since the top qualified dividend rate is 20 percent for taxpayers in the top 39.6 percent bracket. This is in contrast to the 39.6 percent top rate assessed on ordinary income. For taxpayers in the 25 percent through 35 percent ordinary income tax brackets, the top rate on their qualified dividend income is 15 percent. For those taxpayers in the two lowest ordinary income tax brackets, their qualified dividend rate is zero percent. Note that in addition to these rates, qualified dividends may also be subject to the 3.8 percent NIIT.

Long-term capital gains tax rates

If you have invested in a capital asset, then the gain on the sale or exchange of such an asset results in capital gain. The long-term capital gains tax rate, assessed on capital assets held for greater than one year, is 20 percent for taxpayers in the top 39.6 percent tax bracket, 15 percent for taxpayers in the 25 percent through 35 percent tax brackets, and zero percent for those taxpayers in the two lowest tax brackets. Given the reduced rates on long-term capital gains, we will also refer to this income as tax preferential income.

Individual income tax rates by type of income

Given the tax preferential nature of long-term capital gain income, special attention should be given to the holding period of an asset to take full advantage of the long-term capital gain rates. Certain sales of capital assets do not qualify for the lower capital gains rate. A short-term capital gain—or gain on the sale of an asset held for one year or less—is still a capital gain, but is taxed at ordinary income tax rates. Although short-term capital gains are taxed at the same rate as ordinary income, a benefit to short-term capital gains is that they can be offset with capital losses since an individual will net his or her capital gains and losses in arriving at their total capital gain income. Note that if capital losses exceed capital gains, a taxpayer can only deduct up to $3,000 of net capital losses against other income—the balance of their net capital loss is to be carried forward to future years.

Gains from installment sales are taxed at the rate in effect on the date an installment payment is received. Collectibles remain subject to a 28 percent maximum rate.

It is important to remember that more than one type of tax may apply to the same character of income. Therefore, we will now discuss additional taxes that may apply, including employment taxes, AMT, and NIIT.

Holding period

Today's increased tax rate environment

2017 and 2018 federal income tax brackets

Individual income tax rates 2017

Taxable income				PPACA taxes	
Single	Married filing joint			NIIT	FICA-HI
		Ordinary income	Capital gains	Unearned income	Earned income
$0–$9,325	$0–$18,650	10%	0%		
over $9,325–$37,950	over $18,650–$75,900	15%			
over $37,950–$91,900	over $75,900–$153,100	25%	15%		
over $91,900–$191,650	over $153,100–$233,350	28%		if AGI is over $200,00 single/$250,000 MFJ	
over $191,650–$416,700	over $233,350–$416,700	33%		3.8%	0.9%
over $416,700–$418,400	over $416,700–$470,700	35%			
over $418,400	over $470,700	39.6%	20%		

Individual income tax rates 2018

Taxable income				PPACA taxes	
Single	Married filing joint			NIIT	FICA-HI
		Ordinary income	Capital gains	Unearned income	Earned income
$0–$9,525	$0–$19,050	10%	0%		
over $9,525–$38,700	over $19,050–$77,400	15%			
over $38,700–$93,700	over $77,400–$156,150	25%	15%		
over $93,700–$195,450	over $156,150–$237,950	28%		if AGI is over $200,000 single/$250,000 MFJ	
over $195,450–$424,950	over $237,950–$424,950	33%		3.8%	0.9%
over $424,950–$426,700	over $425,950–$480,050	35%			
over $426,700	over $480,050	39.6%	20%		

Self-employment tax

If your income is generated by operating a business as a sole proprietor, a partner in a partnership, or a member of a multimember LLC, you usually are subject to self-employment tax in addition to your ordinary income tax. The self-employment tax rate is 12.4 percent for Social Security tax on self-employment income up to $127,200 for 2017 ($128,700 for 2018) and 2.9 percent for Medicare taxes on all self-employment income. These taxes are in addition to the FICA-HI tax. Once self-employment tax has been calculated, then half of that amount is deductible when calculating overall AGI for that year.

Self-employment taxes vs. FICA taxes

FICA	2017 base	2018 base	Employee rate	Employer rate	Total
Social Security	$127,200	$128,700	6.20%	6.20%	12.40%
Medicare	Unlimited	Unlimited	1.45%	1.45%	2.90%
FICA-HI	$200,000 single $250,000 MFJ	$200,000 single $250,000 MFJ	0.90%	N/A	0.90%
Total			8.55%	7.65%	16.20%

Alternative minimum tax (AMT)

The AMT has evolved into an unwieldy system that continues to ensnare millions of unsuspecting taxpayers and, as a result, the repeal of AMT is frequently debated as part of potential tax reform.

AMT is imposed at a nearly flat rate on an adjusted amount of taxable income above a certain threshold, which is also known as an exemption. The exemption is substantially higher than the exemption from regular income tax. The AMT exemption is indexed for inflation and phased out as taxpayers reach higher levels of AMT income. For 2017 (and 2018), the AMT exemption amount for single filers is $54,300 ($55,400) and begins to phase out at $120,700 ($123,100). It is $84,500 ($86,200) for MFJ filers, for whom the exemption begins to phase out at $160,900 ($164,100).

The ability to apply most nonrefundable personal credits (including the Dependent Care Credit, the credit for the elderly and disabled, the credit for interest on certain home mortgages, and the Hope Education Credit) against the AMT expired at the end of 2011, but was reinstated again on a permanent basis as part of ATRA.

Now that the difference between the highest ordinary income tax rate and the highest AMT rate has increased, as has the AMT exemption, it is likely that fewer taxpayers will be subject to AMT going forward. Still, in order to navigate the AMT, taxpayers must be especially mindful of year-end cash payments, such as fourth-quarter state income taxes (especially in states with high rates), prepayment of investment and tax adviser fees, and charitable contributions. Falling victim to AMT has many possible causes, but you may be particularly prone to AMT if you have any of the following circumstances:

- Large state and/or local income, sales tax, or property tax deductions
- Large long-term capital gains or qualified dividends
- Large deductions for accelerated depreciation
- Large miscellaneous itemized deductions
- An exercise of incentive stock options
- Large amounts of tax-exempt income that is not exempt for state tax purposes
- A large number of dependents
- Tax-exempt income from private activity bonds
- Mineral investments generating percentage depletion and intangible drilling costs
- Research and development expenses in activities in which you do not materially participate

Current-year planning around timing of the payment of expenses that constitute itemized deductions not deductible under the AMT system is certainly important, but it may not be enough. In addition, projecting taxable income from hedge and private equity funds, as well as managing private activity bonds, are among activities that take on special significance. More than ever, meaningful AMT planning requires examining multi-year scenarios.

Health care taxes

As we have previously discussed the creation of the heath care taxes, it is now important to put the taxes in the context of how they apply to particular types of income. Note that each of these taxes are in addition to other taxes that are assessed on these types of income.

NIIT

An additional 3.8 percent NIIT is imposed on unearned income, such as interest, dividends, capital gains, annuities, royalties, rents, and income from businesses in which the taxpayer does not actively participate (income not earned from a trade or business and income subject to the passive activity rules).

Because the tax applies to gross income from these sources, income that is excluded from gross income, such as tax-exempt interest, will not be taxed. The tax is applied against the lesser of the taxpayer's net investment income (after investment-related and allowable deductions) or modified AGI in excess of the threshold amounts. These thresholds are set at $200,000 for single filers and $250,000 for MFJ filers. Some types of income are exempt from the tax, including income from businesses in which the taxpayer actively participates, gains from the disposition of certain active partnerships and S corporations, distributions from qualified plans and individual retirement accounts, wages, and any item taken into account in determining self-employment income.

FICA-HI tax

An additional 0.9 percent FICA-HI tax applies to earnings of self-employed individuals or wages of an employee received in excess of $200,000 ($250,000 if MFJ). Self-employed individuals will not be permitted to deduct any portion of the additional tax. If a self-employed individual also has wage income, then the threshold above which the additional tax is imposed will be reduced by the amount of wages taken into account in determining the taxpayer's liability.

NIIT

A **3.8 percent** tax levied on certain unearned income of individuals with AGI over $200,000 ($250,000 for MFJ filers).

Net investment income means the excess of the sum of gross income from the following over allowable deductions:

- Interest
- Dividends
- Capital gains
- Annuities
- Rents and royalties
- Passive activities and trading partnerships

Does NOT apply to:

- Wages
- Self-employment income
- Distributions from qualified plans
- Income that is derived in the ordinary course of a trade or business and not treated as a passive activity

FICA-HI tax

Employee share increases by **0.9 percent** (2.35 percent, up from 1.45 percent) for an individual's wages, compensation, or self-employment income that exceeds threshold amount for filing status:

MFJ	Married filing separately	Single
$250,000	**$125,000**	**$200,000**

Self-employed individuals are not permitted to deduct any portion of the additional tax. This change does not change the employer hospital insurance contribution.

Health care taxes

Consider the example of married taxpayers who earn $750,000 in wages. Additionally, their investment income consists of $250,000 of interest and dividends and $1,000,000 of capital gains, with properly allocable deductions of $70,000, for total net investment income of $930,000. Their total additional taxes under the PPACA is $39,840.

Married taxpayers, filing jointly

Type and amount of income		Applicable PPACA tax	Applicable threshold	Income subject to applicable PPACA tax	Tax rate	Additional tax
Wages	**$750,000**	FICA-HI	($250,000)	$500,000	0.90%	**$4,500**
Investment income						
Interest/Dividends	$250,000					
Capital gains	$1,000,000					
Properly allocable deductions	($70,000)					
Net investment income	**$1,180,000**	Net investment income tax (NIIT)	($250,000)	$930,000	3.80%	**$35,340**
Total additional tax						**$39,840**

State and foreign taxes

Having worked our way through the various federal taxes that can be assessed, there are still income taxes from other jurisdictions to be addressed. While a thorough discussion of all possible taxes imposed by states or foreign countries is not the purpose here, no income tax planning exercise is complete without considering the potential for taxes from all possible jurisdictions.

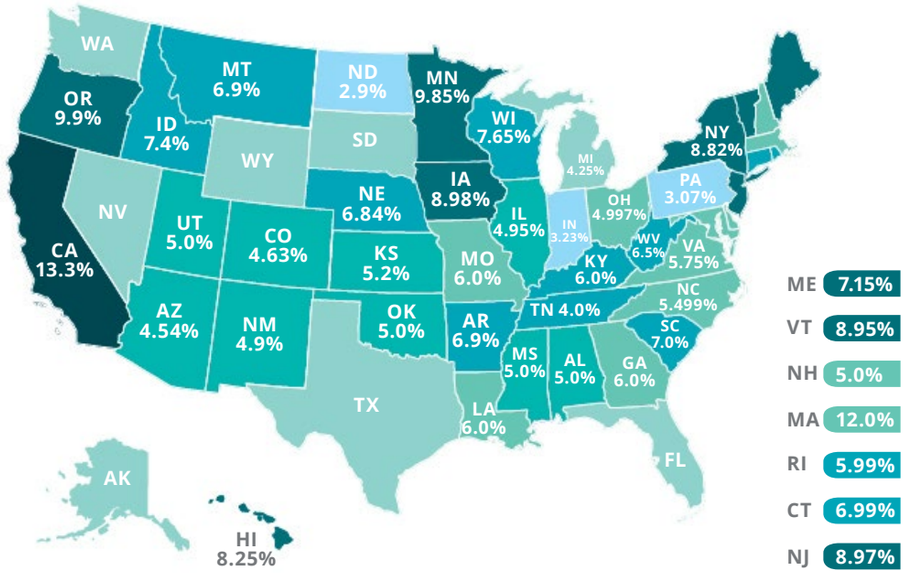
States such as Florida, Nevada, South Dakota, Texas, Washington, and Wyoming do not have individual income taxes, but most states do—with California having the highest rate of more than 13 percent. If an individual is subject to income taxes in multiple states, it may be possible to generate a state tax credit in the resident state to reduce the overall tax burden.

Individual consumers may also be subject to sales and use taxes. When the governing body collects the tax at the point of purchase, it is called a sales tax. Alternatively, when a tax on goods or services is paid to a governing body directly by a consumer, it is usually called a use tax. The imposition of these taxes may be an important consideration when an investment is a commodity, such as an airplane or art.

Finally, if income is earned in a foreign jurisdiction, then it may be subject to foreign taxes. Similar to the state tax credit, a foreign tax credit may be available when income is subject to tax in multiple jurisdictions.

How high are income tax rates in your state?

Top state marginal individual income tax rates as of July 1, 2017



ME	7.15%
VT	8.95%
NH	5.0%
MA	12.0%
RI	5.99%
CT	6.99%
NJ	8.97%
DE	6.6%
MD	5.75%
DC	8.95%

Look again: Year-round personalized planning

With a solid understanding of the various taxes that may be assessed on your income and the importance of planning for this meaningful liability, you are now equipped to look again at the issues that are presented to you based on your personal tax situation. When we say considerations, we like to think of those as levers that you can engage.

What lever can you pull that may position you for a potentially more tax-efficient result?

Considering the potential for a decrease in your overall tax rate, maybe your lever is to take steps to defer income to a subsequent year. Similarly, considering the potential changes to itemized deductions, maybe your lever is to accelerate a deduction or expense into the current year. Either way, think of these levers as tools within your control that you can use to affect your tax result. By implementing a long-term commitment to holistic tax planning, you likely will identify many different levers to consider each year and position yourself to navigate today's increased tax rate environment more efficiently.

To be more effective in your efforts, it is best to not think of your tax situation based on the income you expect to realize or the deductions you expect to incur. To only think of income planning approaches or deduction planning strategies is to think in a vacuum. That is not the way that it works when you file your taxes—everything is taken into consideration when calculating your tax bill. So we encourage you to think of planning here as a year-round process, taking into consideration all the levers you can pull, be they income or deduction decisions—to create a more efficient tax result.

As you think about this, keep in mind that the levers you will consider will be different than levers someone else would consider because each of us has a unique tax posture and different goals and objectives. There is no one-size-fits-all approach that applies to everybody. You should focus on your planning based on your own specific fact pattern and objectives. Even if your income posture is identical to someone else's, maybe you are charitably inclined and they are not. Perhaps both of you are charitably inclined, but you plan to fund your charitable donations soon whereas the other person plans to fund his or her donations as part of an estate plan. So your levers become very specific and unique to you based on your tax posture and your personal goals and objectives.

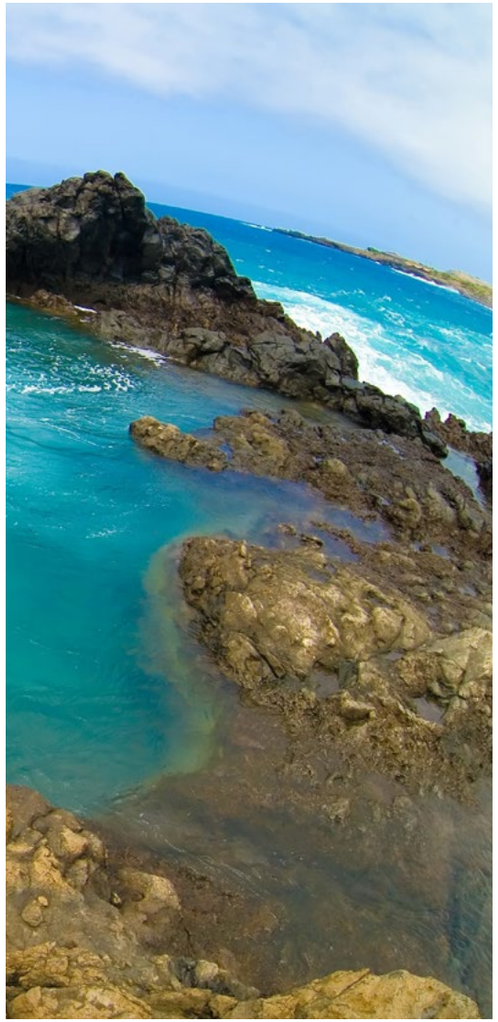
Understanding this is critical in tax planning because it shines a direct light on specific considerations for tax efficiencies for you and facilitates the pursuit of your goals and objectives. As part of your long-term commitment to holistic tax planning, recognize that each year may present different issues that motivate you to look again at your goals based on that specific year's activity. For example, maybe this year you have a significant ordinary income event, but you expect a significant long-term capital gain event next year. Maybe this year you expect an operating loss from your business enterprise, but next year you project the business to turn around and be highly profitable. Obviously, the likelihood of anticipated legislative changes will also need to be considered.

Year-round personalized planning

To start to think about this in more detail, we encourage you to consider the character and the timing of your income and your deductions, as not all items of income or deductions are equal. As reviewed earlier, some income, like wages, is subject to ordinary tax rates as high as 39.6 percent. Other income, like long-term capital gains or qualified dividend income, is subject to tax preferential rates that only go as high as 20 percent. Some items of income are more easily controllable when you recognize the income event, for example, when to realize the long-term capital gain that is currently in your portfolio. Other items of income may be less controllable by you, such as the amount and timing of your company bonus.

The issue is even more complex for your deductions. Some deductions are easily controllable in terms of their timing, like your charitable contributions. However, they may still carry an array of tax issues, such as the funding of that charitable donation (cash versus stock versus other assets), let alone the optimal year to fund the donation. Some deductions are less controllable, like interest expense and real estate taxes, as you generally pay those when they become due. If that is not enough, consider that some deductions may provide significant value if you are not subject to the AMT. Conversely, those same deductions may provide no benefit if you are subject to AMT.

This year, there is the added issue that tax reform has included discussion about elimination of certain deductions, such as the deduction for state income taxes or a higher standard deduction that would eliminate the need to itemize deductions all together. As you digest this, you can begin to see that controllability is a significant lever for you to consider for both income and deduction items.



Year-round personalized planning

Putting all of this into perspective may be easier when you consider these important points:

1. Items that are controllable provide flexibility for determining the more optimal time for tax recognition of that item. This is equally applicable to items of income as it is to items of deduction.

2. Some items are automatically going to occur—you will pay your real estate taxes when they are due (or face a penalty for not doing so), and you will earn your wages when they are earned. Often these automatic events lay the foundation of your planning. In essence, enhance the efficiency you can gain from your controllable events against the backdrop of your noncontrollable events.

3. Controllable deductions may be one of your biggest levers. Again, an example would be when and how do you want to fund your charitable gifts. Will you use securities or an alternative asset? Recognizing that there are more efficient ways to fund these deductions—both in terms of the when and the how—allows you to reach a greater level of tax efficiency. Your personal tax situation will afford you some additional considerations today, in future years, and, in some instances, even prior years. Making sure you review it holistically and commit to thoughtful tax planning is likely to position you to realize a greater degree of tax efficiency than you otherwise might expect.

4. Your personal tax situation will afford you some additional considerations today, in future years, and, in some instances, even prior years. Making sure you review it holistically and commit to thoughtful tax planning is likely to position you to realize a greater degree of tax efficiency than you otherwise might expect.

5. Do not lose sight of the fact that if you are an owner of, or invest in, pass-through entities, the more thoughtful planning that you may need to undertake to position yourself for an efficient tax result may be planning within those entities as opposed to planning by you directly. Failing to coordinate tax planning between a flow-through entity and the owners of that flow-through entity will likely undercut tax efficiency.

6. Before acquiring new investments, take time to understand the character of the income that will be generated by the investment as well as when you will recognize the income and any potential new disclosure obligations that may arise. Furthermore, analyze whether you will benefit from the expenses and losses allocated to you. The deduction for some expenses may be limited by the itemized deduction phaseout provisions or added back under the AMT regime. Furthermore, losses may be disallowed in the current year if you are subject to the passive loss rules. Failing to understand the character of income and expenses that the pass-through entity will pass through to you may lead to unwelcome surprises when you receive the final tax information.

Whatever lever you choose to pull, ensure that you are actively planning to reach an efficient result for the current year. No matter what issues, including tax reform, are in your peripheral view, you must remember to put your income tax planning goals front and center. In order to accomplish this, look again at all of the planning levers that are available to you now—and consider whether or not those levers will exist in the future. Discussions with your tax adviser can give you insights into how to strategically plan for your financial goals and objectives.

This guide is meant to help you apply these considerations to your unique goals and objectives and open the door to tax-efficient planning with your adviser.

Planning for long-term gains

You want to diversity your portfolio and recognize a substantial long-term capital gain in 2017. You may have some losses in your portfolio, but would not have sufficient losses to offset the gain in full. There are no loss carryovers. What potential issues, among others, should be considered in deciding if the gain should be recognized?

Capital gains tax rate for 2017, including NIIT implications, is known, whereas it is uncertain for 2018.

Capital losses may be more valuable in 2017 than 2018, because the capital gains tax rate for 2017, including NIIT implications, is known, whereas it is uncertain for 2018.

Higher AGI base in 2017 may be helpful for those that wish to accelerate charitable giving.

When should the state tax liability be paid on income that is recognized? Are there AMT implications?

Deductions may be more valuable in 2017 depending on what income is being offset and the potential for lower rates for 2018.

What's the implication of the stock value and investment risk if you decide to hold off on diversification until 2018?

What could be done to mitigate state tax exposure if recognition of the capital gain is deferred?

Planning for charitable contributions

You have a history of making generous charitable contributions. You have pledged a significant contribution to your alma mater, but the university has given you the option of making the contribution over time. What potential issues, among others, should be considered in deciding when to make the contribution?

Deductions might be more valuable in 2017 depending on what income is being offset, as well as the potential for lower rates in 2018.

Consider potential tax reform that could affect the tax benefit of your charitable giving.

Are there AMT implications to consider?

How would you address the implication of the Pease limitation on itemized deduction existing in 2017, but possibly not existing in 2018?

Assuming you are contributing stock, then how does market risk affect your thought process?

Wealth transfer planning

There is no easy way to say it—anticipating one's death is an uncomfortable topic. Yet it is often worth pushing past the initial discomfort to pursue the potential rewards of effective wealth transfer planning. Once your estate plan is in place, periodic reassessment will help determine that it reflects recent life events, market and regulatory changes, and evolving legacy objectives. An effective plan may lessen the likelihood of family conflict, reduce estate costs, reduce taxes, and preserve wealth. Gathering an effective team of advisers will help facilitate the success of this ongoing process.

Take another look...

Wealth transfer planning determines how you will "slice up the pie" and encompasses the many activities necessary to confirm that your affairs are in order and the parties succeeding to your wealth do so as you intend. Keeping your wealth transfer plan current is essential to its success.

The wealth transfer planning process

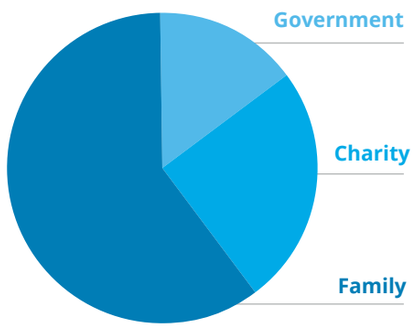
Establishing who gets what, how they get it, and when they get it are, as a general rule, personal matters. But these decisions can have significant financial implications. While it is human nature to procrastinate on such issues, the entire family benefits if these matters are addressed.

Your wealth transfer plan anticipates the probability of future events in the face of imperfect knowledge. Consequently, it will always remain a work in progress, warranting periodic updates as anticipated events occur (or not), as market and regulatory developments occur (or not), and as new planning considerations arise (or not).

For your part, retaining competent advisers is important to help you navigate the wealth transfer tax system and understand how that system shapes the variety of effective planning considerations available to you. For example, statutory inflation adjustments impact the amount of assets that can be transferred free from tax each year and shifting regulations may alter, for example, how those assets are valued. Therefore, we invite you to look again at this framework and how it shapes your evolving wealth transfer plan.

You can't take it with you—so where do you want your wealth to go?

There are three places your assets can go at your death: to your family and friends, to charity, or to the government in the form of taxes. For wealthy individuals subject to high estate taxes, effective wealth transfer planning helps you make confident decisions about the manner in which your wealth will be transferred after your death.



A note on tax reform:

As this edition of the wealth guide goes to press, separate tax reform bills are moving through the House and Senate that, on the individual side of the code, call for ambitious changes to the estate, gift, and generation-skipping transfer tax regimes.

For more information, see the Tax policy update section of this publication.

Reevaluating your wealth transfer planning goals

For wealthy individuals, the estate plan becomes the blueprint from which a legacy will be established and implemented.

What a wealth transfer plan entails

All estate plans should cover the basics, including having in place a current will, powers of attorney for property and health care (these documents will vary from state to state and may also include health care directives or living wills), and revocable trusts (where appropriate). In addition, planning should provide for guardians for minor children and confirm how assets are currently titled and that current beneficiary designations do not frustrate your intended wealth succession plans.

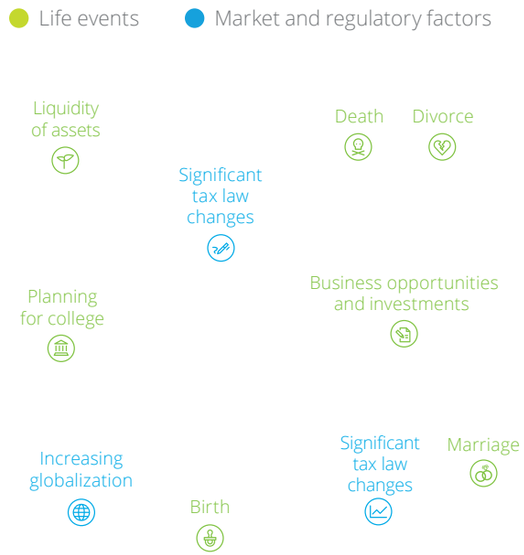
Estate planning checklist

- ☑ Current will
- ☑ Guardian and beneficiary designations
- ☑ Revocable trust
- ☑ Powers of attorney for property and health care

For wealthy individuals, the estate plan must do much more than direct assets as it becomes the blueprint from which a legacy will be established and implemented. Effective planning may reduce the likelihood of family conflict as well as the possible administrative and tax costs associated with your passing.

What facts and circumstances impact your wealth transfer blueprint?

Life events, as well as market and regulatory factors, can impact the wealth transfer planning process. Therefore, it is important for your wealth transfer plan to remain flexible and be revisited and adjusted periodically.



Transfer tax fundamentals

Increasing tax efficiency can provide for greater wealth transfer to heirs and/or charity, and is therefore an integral part of the wealth transfer planning process.

The transfer tax system includes three separate taxes: the gift tax, the estate tax, and the generation-skipping transfer (GST) tax.

Gift tax basics

Most uncompensated (or insufficiently compensated) transfers of property during life are subject to the federal gift tax. The gift tax is computed based on the fair market value of the property transferred. For 2017 and 2018, the top gift tax rate is 40 percent.

Not all transfers generate transfer tax

The following asset transfers are excluded in determining whether a gift tax liability arises:

- Gifts utilizing the lifetime gift tax exclusion amount
- Gifts that qualify for the gift tax annual exclusion
- Certain payments of education and medical expenses
- Certain gifts to your spouse
- Gifts to qualified charitable organizations
- Transfers to certain qualifying organizations (including some political organizations) that have been granted a specific status by the Internal Revenue Service (IRS)
- Nongift transactions (i.e., transfers that do not diminish net worth)

Transfer tax fundamentals

The lifetime gift tax exclusion

The amount of property that each person can transfer tax free is referred to as the applicable exclusion amount. The applicable exclusion amount is used to calculate the credit available to offset the gift tax calculated for current-year transfers. The applicable exclusion amount, which has been indexed for inflation annually since 2012, is currently $5.49 million in 2017 and will increase to $5.6 million in 2018.

Gift tax annual exclusion

In addition to the lifetime gift tax exclusion amount, in 2017 each individual taxpayer is allowed an annual exclusion from gift tax for certain gifts valued up to $14,000 per recipient, which is also indexed for inflation, but only in increments of $1,000. The 2018 annual exclusion amount is $15,000. To qualify for the gift tax annual exclusion, gifts must be of a present interest. A present interest implies that the donee has a substantial present economic benefit arising from the gift property.

Many outright transfers qualify for the annual exclusion, including gifts of cash, marketable securities, and income-producing real estate. Transfers under the Uniform Transfer to Minors Act and funds contributed to section 529 educational savings plans qualify as present interest gifts by statute. However, most transfers that restrict access to the transferred assets will not qualify. For example, most transfers in trust cannot qualify as a present interest unless the beneficiary is given the immediate right to withdraw liquid assets of some set amount out of the trust. Similarly, transfers of interests in illiquid intangible assets—for example, certain family investment entities that do not consistently distribute earnings to their owners—may not qualify for the annual exclusion.

The power of annual gifting

Assume a couple has three married children and three grandchildren. In 2018, each spouse can transfer up to $15,000 per person free of gift tax. The couple could give $90,000 to their children, $90,000 to their children's spouses, and $90,000 to their grandchildren—a total of up to $270,000—without using any of the couple's combined $11.2 million lifetime gift tax exclusions ($5.6 million per person) and not incur any gift tax. Transferring assets today via annual exclusion gifting can also save future estate taxes. Under this scenario, assuming an applicable estate tax rate of 40 percent, and assuming combined wealth in excess of the then applicable exclusion amount, $108,000 of future estate tax is saved.

Transfer tax fundamentals

Education and medical gift exceptions

Tuition payments made directly to educational institutions and certain payments made directly to health care providers are not taxable gifts and do not absorb a gift tax annual exclusion. For example, a grandmother who wishes to help pay for a granddaughter's education can write tuition checks directly to the school and give her $14,000 in cash without making a taxable gift. However, if she reimburses her granddaughter for tuition the granddaughter paid, she will have made a taxable gift to the extent the amount gifted exceeds the $14,000 annual exclusion (in 2017). Tuition is not limited to college tuition; any qualified school's tuition can be excluded. Medical expense does not just mean those for doctors and hospitals; any qualified medical expense, including health insurance premiums, can be paid under this exclusion.

The power of tuition payments

Continuing the example from the prior page, let's assume the couple also pays the annual college tuition costs of their three grandchildren this year. Assuming the annual tuition cost is $30,000 per grandchild, an additional $90,000 can be transferred gift tax free, and an additional $36,000 of future estate tax is saved.

Gifts to your spouse

Outright gifts to your spouse, assuming the spouse is a US citizen, qualify for an unlimited marital deduction and are not subject to gift tax. Gifts to noncitizen spouses are instead subject to an annual exclusion limitation ($149,000 and $152,000 for 2017 and 2018, respectively).

Gifts to qualified charitable and other tax-exempt organizations

Certain gifts to qualified charitable organizations qualify for the unlimited gift tax charitable deduction and are not subject to gift tax. This includes transfers to donor-advised funds. For gifts after December 19, 2015, the gift tax also does not apply to transfers to certain qualifying organizations (including some political organizations) that have been granted a specific status by the IRS.

Nongift transactions

Nongift transactions may include such transfers as a sale of property between family members for full and adequate consideration, or an intra-family loan arrangement that provides for adequate interest. Other more sophisticated techniques, including the use of the classic zeroed-out grantor retained annuity trust (GRAT), can also result in a zero-value gift. In many cases, although the transfer results in a zero-value gift, it is prudent to nonetheless adequately disclose the transaction on the transferor's gift tax return in order to start the statute of limitations on that transfer.

Transfer tax fundamentals

Estate tax basics

The estate tax is imposed on the fair market value of all assets includible in your estate at the time of your death and the value of taxable gifts you made during your lifetime. The only permitted reductions to the taxable estate are debts and expenses of administration, the value of assets passing in a qualified manner to one's spouse, the value of qualified assets passing to qualified charities, and the applicable exclusion amount at the date of death. The applicable exclusion amount for 2017 is $5.49 million, increasing to $5.6 million for 2018. Generally, if the total of one's gross estate and prior gifts exceeds the applicable exclusion amount at the date of death, the excess is taxed at the then top marginal transfer tax rate, which is 40 percent in 2017 and 2018.

Qualified transfers to a spouse who is a US citizen are covered by the unlimited marital deduction, so such transfers may be made totally free from the estate tax. Thus, with proper planning, the estate tax for married individuals can be deferred until the death of the surviving spouse. Most transfers to qualified charities are covered by an unlimited charitable deduction.

However, leaving all of your assets to your surviving spouse and/or charitable organizations does not eliminate the need to develop an estate plan, nor is it necessarily tax efficient since, for example, there are assets that, if passed to a surviving spouse or a charity, do not qualify for the marital or charitable deductions.

Calculating the estate tax

If a single individual with no previous lifetime gifting, a gross estate of $20 million, and an estate plan leaving all assets to his or her children were to die in 2017, his or her estate would owe $5,804,000 in estate tax. Due to the increase in the applicable exclusion amount, if this same individual were to die in 2018, the estate tax would be reduced to $5,760,000.

	DOD in 2017	DOD in 2018
Gross estate	$20,000,000	$20,000,000
Estate tax rate	40%	40%
Gross estate tax	$7,945,800	$7,945,800
Less unified credit	$(2,141,800)	$(2,185,800)
Net estate tax	$5,804,000	$5,760,000

Transfer tax fundamentals

Generally, the assets included in the estate of a decedent take an income tax basis equal to their fair market value at the date of death. Thus, except with respect to specific exceptions, any inherent income, gain, or loss at the date of death is extinguished.

Some assets are not allowed a basis step up upon a decedent's death and therefore may be subject to double taxation (income and estate tax). For example, income in respect of decedent (IRD) are assets that are income that the decedent was entitled to but did not recognize prior to death (generally because of a method of accounting—the cash method or the installment method). IRD assets take carryover basis from the decedent (which is generally zero). Common IRD assets include uncollected wages, deferred compensation, and retirement accounts; rents, royalties, interest, or dividends accrued but unpaid at death; unrecognized gains from pre-mortem sales; and certain nonqualified stock options. Although the taxpayer succeeding to IRD assets is allowed an income tax deduction related to the amount of federal estate tax allocable to such assets, the deduction (unlike a credit) only reduces the burden of double taxation; it was never intended to eliminate it. Double taxation can be avoided by passing IRD assets to the surviving spouse or to a charity.

A note on portability

A surviving spouse can use his or her own basic exclusion amount ($5.49 million in 2017, $5.6 million in 2018) plus the unused exclusion amount of his or her most recent deceased spouse to offset the tax on the survivor's subsequent gifts or to offset his or her taxable estate. The deceased spouse's unused exclusion amount is available to the surviving spouse only if the executor of the deceased spouse's estate makes a portability election by filing an estate tax return and computes the exclusion amount to which the surviving spouse is entitled. Note that the GST tax exemption (discussed later) is not portable.

As favorable as the potential simplicity promised by portability may be, it is unlikely to be as tax effective as conventional estate planning, particularly for high net worth families. Conventional estate planning involves spouses that each have wealth equal to at least their basic exclusion amount and affirmatively planning its use.

Transfer tax fundamentals

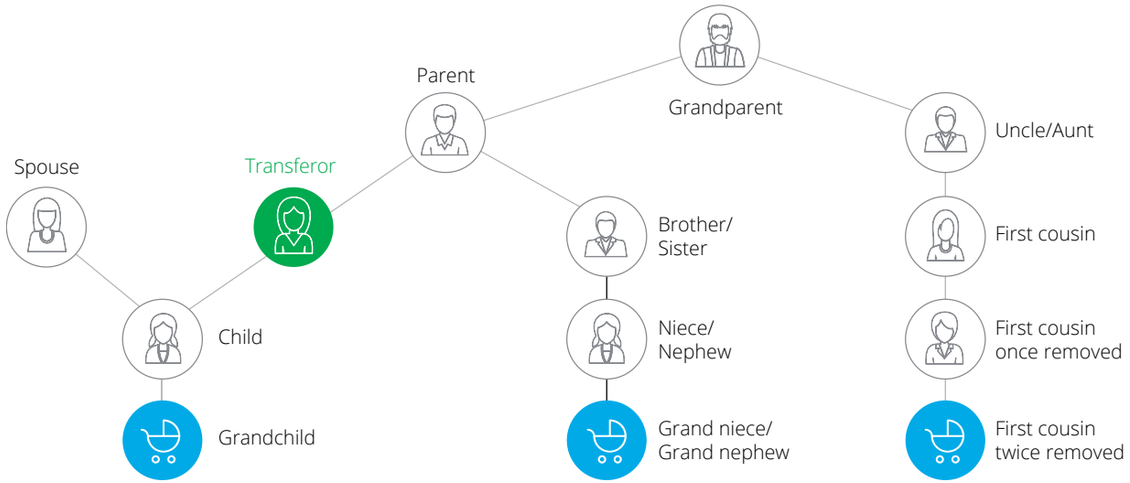
GST tax basics

The GST tax is imposed in addition to the gift and estate tax on direct or indirect transfers or bequests made to a "skip person"—a recipient who is at least two generations younger than the donor or decedent, such as a grandchild. An indirect transfer arises when a skip person is either distributed assets from or becomes indefeasibly vested in the assets of a trust.

If there were no GST tax, a transfer to a grandchild would be subject to the gift or estate tax once, while a gift to a child who then further gifts or bequeaths those assets to their child would be subject to transfer tax twice. The GST tax is intended to tax the transfer to the grandchild twice at the time it is made (through both the gift/estate tax and the GST tax), to compensate for the otherwise skipped level of tax. Furthermore, with respect to a taxable gift to a skip person, the cash used to pay the GST tax is also subject to the gift tax.

Generation assignment—related parties

(blue = skip person with respect to the transferor)



Transfer tax fundamentals

For GST tax purposes, when a gift or bequest is made within a family, the focus is on the relationship of the transferor and the transferee and not their age difference. The age difference is important only for nonrelatives.

Generation assignment—unrelated parties

(blue = skip person)

Transferor

Nonfamily member
up to 37.5 years younger

Nonfamily member
> 37.5 years younger

The GST tax exemption amount protects that amount of assets until they pass into the hands of a skip person. Thus, an outright gift to a grandchild is protected, but those assets are still subject to gift, estate, or GST tax when transferred by the grandchild. A trust can be made exempt from GST until it distributes assets to a skip person, but the distributed assets are still subject to gift, estate, or GST tax when further transferred by the skip person. The GST tax exemption in 2017 is $5.49 million, increasing to $5.6 million in 2018, coinciding with the gift and estate tax applicable exclusion amount. The GST tax rate is equal to the maximum federal estate tax rate (40 percent in 2017 and 2018) for the year that the skip person receives or becomes permanently vested in assets.

There is also an annual exclusion amount available for transfers subject to the GST tax. The GST tax annual exclusion amount, like the gift tax annual exclusion amount, is $14,000 for transfers made in 2017 and $15,000 for transfers made in 2018. Unlike the gift tax annual exclusion however, the GST tax annual exclusion is very limited for gifts to trusts.

Transfer tax fundamentals

Many state transfer taxes are patterned after the federal transfer tax system. However, there are differences, and state taxes may be incurred even in situations in which there is no federal tax.

State transfer taxes

One benefit of wealth transfer planning by gift rather than by bequest may be the avoidance of state transfer taxes. Connecticut is the only state that currently has a gift tax. Thus, for many wealthy taxpayers, lifetime transfers may only result in a federal tax, but transfers at death may result in both a federal and state transfer tax.

Many state transfer taxes are patterned after the federal transfer tax system. However, there are differences, and state taxes may be incurred even in situations in which there is no federal tax. As of January 2017, 14 states and the District of Columbia impose an estate tax, while six states have an inheritance tax. Maryland and New Jersey have both. The estate tax has been repealed for 2018 and beyond in Delaware and New Jersey (though New Jersey's inheritance tax remains). Remember that estate taxes are generally borne by the estate whereas inheritance taxes are borne by the beneficiary receiving assets from an estate.

Of note, only three states with an estate tax (Delaware, Hawaii, and Maine) have an exclusion that matches the inflation-adjusted federal exclusion amount. New York and Maryland are set to match the federal exclusion amount starting in 2019. In the states that have an exclusion amount smaller than the federal amount, unless planned for, an estate/inheritance tax may arise upon the death of the first spouse where the testamentary plan is built upon the federal exclusion amount.

The variety in state tax rules requires transfer tax planning focused not by the federal rules but by the rules of one's state of legal domicile. In states that have estate and/or inheritance tax exclusions smaller than the federal exclusion, transfer tax planning with respect to the first death is paramount. In states without transfer taxes but with high income taxes, tax planning is balanced between federal estate tax planning and income tax basis planning for inherited assets.

Calculating the state estate tax

If a single individual with no previous lifetime gifting, a gross estate of $20 million, and an estate plan leaving all assets to his or her children were to die in 2017, and this individual also resided in Vermont, his or her estate would owe $2,760,000 in state estate taxes. For federal estate tax purposes, a deduction would be allowed for state death taxes, resulting in an estate tax of $4,700,000.

	Federal estate taxes	State estate taxes
Gross estate	$20,000,000	$20,000,000
State death tax deduction	$(2,760,000)	N/A
Taxable estate	17,240,000	$20,000,000
Estate tax rate	40%	16%
Gross estate tax	**$6,841,800**	**$3,200,000**
Less unified credit	$(2,141,800)	$(440,000)
Net estate tax	**$4,700,000**	**$2,760,000**

Transfer tax fundamentals

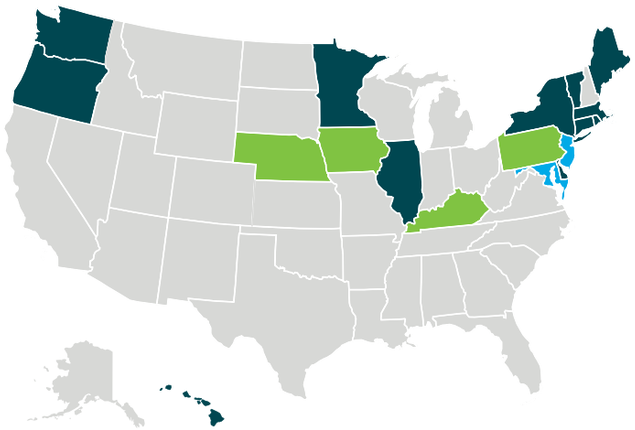
Gift tax
Estate tax
Generation-skipping transfer tax
State transfer taxes

State estate and inheritance tax rate and exemptions in 2017

State	Estate tax	Inheritance tax
Connecticut	$2M; **7.2%-12%**	
Delaware*	$5.49M; **0.8%-16%**	
Hawaii	$5.49M; **10%-15.7%**	
Iowa		0%-15%
Illinois	$4M; **0.8%-16%**	
Kentucky		0%-16%
Maine	$5.49M; **8%-12%**	
Maryland	$3M; **16%**	0%-10%
Massachusetts	$1M; **0.8%-16%**	
Minnesota	$2.1M; **10%-16%**	
Nebraska		1%-18%
New Jersey*	$2M; **0.8%-16%**	0%-16%
New York	$5.25M; **3.06%-16%**	
Oregon	$1M; **10%-16%**	
Pennsylvania		0%-15%
Rhode Island	$1.515M; **0.8%-16%**	
Vermont	$2.75M; **16%**	
Washington	$2.129M; **10%-20%**	
District of Columbia	$2M; **8%-16%**	

* The estate tax has been repealed for 2018 and beyond in Delaware and New Jersey (though New Jersey's inheritance tax remains).

Note: Exemption amounts are shown for state estate taxes only. Inheritance taxes are levied on the posthumous transfer of assets based on the relationship to the descendant; different rates and exemptions apply depending on the relationship.



- State has an estate tax
- State has an inheritance tax
- State has both an estate and inheritance tax
- State has no transfer tax

Effective wealth transfer planning 101

Armed with a basic understanding of the wealth transfer tax system, let's consider some fundamental components of effective wealth transfer planning.

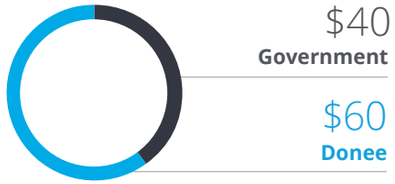
The tax efficiency of transferring assets during life

Family wealth is preserved when it is taxed at the lowest possible combined federal and state effective tax rate. The gift tax is assessed only on the value of the property transferred, whereas the estate tax is assessed on the aggregate value of all of the decedent's wealth, including the funds with which the estate tax will be paid. Thus, the effective tax rate for gifts is always lower than for bequests.

The "tax exclusive" nature of the gift tax makes taxable gifts a generally more efficient method of transferring wealth. Federal and state governments, aware of this advantage, generally require the gift taxes paid with respect to any gifts made within three years of death be added back to the gross estate. Doing so recaptures the "tax exclusion" benefit and thereby discourages so-called "deathbed transfers."

Consider this simple example:
You die with $100 in a state that does not levy an estate or inheritance tax and are subject to a 40 percent federal estate tax rate. In this case, $40 will go to the government to cover your estate tax liability, and $60 will go to your heirs.

Estate tax



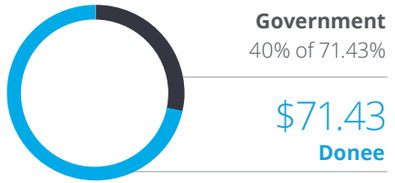
$40
Government

$60
Donee

As an alternative, let's say you elected to make a gift (and satisfy the related gift tax) of the same $100 during your lifetime. Because the gift tax is an "exclusive" tax, the amount subject to gift tax is only the amount transferred.

Assuming the same $100 is available for distribution and the gift tax rate is 40 percent, you can transfer $71.43 of the $100 to the donee, and only $28.57 (40 percent of the $71.43 transferred) would be remitted to the government to satisfy your gift tax liability.

Gift tax



$28.57
Government
40% of 71.43%

$71.43
Donee

This increased transfer opportunity—$71.43 versus $60 in our example—demonstrates how much more efficient it is to transfer assets during one's lifetime rather than at death. This conclusion remains true even taking into account the time value of money, but assumes, as mentioned above, that the donor survives the third anniversary of the gift.

Effective wealth transfer planning 101

The effective use of trusts

Trusts have been used by wealthy families for centuries to protect, oversee, and manage wealth, passing it from one generation to the next. Trusts regulate access to assets by beneficiaries (typically younger family members or those without the legal or mental capacity to own assets outright).

Almost any dispositive planning can be accomplished with a trust. This, however, requires a skilled draftsman because once the trust becomes irrevocable, changes, while possible, are problematic. Moreover, trusts operate under state law, which often limits both the trust's duration and a trustee's conduct. Thus, choosing the governing state law is an important consideration.

A trust can be regarded for income and/or transfer tax purposes depending upon, among other things, the participation of the settlor (the person who created the trust). A trust can be disregarded for estate tax purposes if the settlor retains either an economic interest in or broad powers over the disposition of trust assets. For example, a revocable trust, while legally binding, is disregarded for both income and transfer tax purposes until the settlor dies. In contrast, an irrevocable grantor trust is regarded for estate tax purposes, but, due to the settlor's retained powers, is designed to be disregarded for income tax purposes. Accordingly, care must be exercised that the trust agreement supports the intended result—having a trust disregarded that was intended to be regarded is likely to have dilatory wealth transfer tax consequences.

An irrevocable grantor trust can be excludible from the grantor's estate. However, the grantor recognizes and pays income tax annually on the trust's taxable income. As such, the grantor is consuming his or her remaining estate assets to pay tax on income that is not his or hers. Over time, the cumulative effect can be meaningful.

The importance of valuation

For many wealthy taxpayers, the $5.6 million exclusion amount ($11.2 million per couple) is more than enough to cover their lifetime wealth transfer goals—thus reducing the need for more complicated wealth transfer transactions.

Others may decide to gift minority interests in closely held businesses, private equity funds, or other investment entities, such as family investment partnerships or limited liability companies or fractional interests in real estate.

Traditionally, a minority interest in a closely held family enterprise is valued at less than its proportionate share of going concern value (for a business enterprise) or net asset value (for an investment entity) due to valuation discounts applied for lack of control and/or marketability. Such discounts allow for more tax-efficient wealth transfers as minority interests in these family-owned enterprises may be passed at a relatively lower transfer tax value.

Section 2704 proposed regulations withdrawn

Proposed regulations under section 2704 published in August, 2016 had the potential to significantly reduce minority and marketability discounts relative to their current formulation when determining gift and/or estate tax values of interests in family-controlled entities.

On October 20, 2017, the IRS withdrew the proposed regulations due to concerns the current administration has developed over the administrative burdens they might impose. Because the proposed regulations were never enacted, their withdrawal will leave the current state of valuation methodology and empirical interpretation unchanged.

Effective wealth transfer planning 101

The family uses of leverage

Parents can lend money to their children, trusts for their children (especially grantor trusts), or entities owned by their children and charge interest at the IRS-prescribed applicable federal rate (AFR)—the minimum rate required to be charged between related parties. In today's interest rate environment, the AFR is significantly lower than the rate at which most individuals would be able to borrow from a bank.

The borrowed funds would be invested in assets (perhaps assets acquired from the grantor) anticipated to earn a rate of return greater than the interest rate being charged by the lender. If the asset's performance meets expectations, the child, trust, or business will accumulate wealth in which the lender's only participation is the interest rate. Of course, there may be gift tax consequences to the lender if the borrower defaults on the loan, or if it is apparent from the totality of the transaction that repayment of the loan was never anticipated.

The advantage of lending and selling assets to a grantor trust is that, for income tax purposes, because the grantor is deemed to own the trust and its assets, transactions between a grantor and his or her grantor trust are disregarded. Thus, they generate no income tax attributes (such as interest income or expense, gain on sale, etc.).

Consider this example:

Assume you identify an investment in which you wish to invest $1 million. However, instead of personally investing, you lend $1 million to a grantor trust for your child's benefit. The trust makes the investment, which achieves a 7 percent annual rate of return. The promissory note provides for interest-only payments over the note's nine-year term and a balloon payment of principal at the end of the term. The interest rate is set at the mid-term AFR, which we will assume is 2 percent.

In this scenario, after the note is paid off at the end of the term with the sales proceeds of the investment, the trust retains $598,899 that would otherwise have been in your estate had you made the investment. The opportunity savings is $239,560 in estate tax savings on the retained earnings (at a 40 percent tax rate). (Note, there is an additional element of estate tax savings associated with the income tax paid by the grantor on the sale of the investment that is not contemplated here.)

Facts

Loan amount	$1,000,000
Interest rate on promissory note	2.00%
Assumed rate of return	7.00%

Result

	Beginning balance	Return	Note payment	Ending balance
Year 1	$1,000,000	$70,000	$20,000	$1,050,000
Year 2	$1,050,000	$73,500	$20,000	$1,103,500
Year 3	$1,103,500	$77,245	$20,000	$1,160,745
Year 4	$1,160,745	$81,252	$20,000	$1,221,997
Year 5	$1,221,997	$85,540	$20,000	$1,287,537
Year 6	$1,287,537	$90,128	$20,000	$1,357,665
Year 7	$1,357,665	$95,037	$20,000	$1,432,701
Year 8	$1,432,701	$100,289	$20,000	$1,512,990
Year 9	$1,512,990	$105,909	$1,020,000	$598,899

Value removed from taxable estate	$598,899
Estate tax savings (assuming 40% rate)	$239,560

Effective wealth transfer planning 101

Transferring value can be independent from transferring control

Many wealthy individuals are reluctant to make lifetime transfers of wealth because they feel that they will lose their ability to manage or control the transferred assets. This fear of relinquishing control can often delay or completely derail the implementation of effective wealth planning.

One's gross estate also includes assets to which the decedent once held title, but transferred for less than equal value in exchange, in a manner such that he or she continued to enjoy the assets, their income, or had the power to determine who would enjoy the assets or their income. The classic example is one in which assets are transferred to a revocable trust. The assets of such a trust are included in the gross estate at their date of death value because the retained power of revocation permits ultimate control of the beneficial enjoyment of the trust's assets.

This treatment, however, has been extended to trusts for the benefit of others and to partnerships and corporations to which the decedent contributed assets in exchange for an equity interest. If the decedent is found to have retained too much control, the value of the transferred assets at the date of death will be included in the gross estate, not the value of the equity interest actually owned. Consequently, transfer tax planning will be effective only where the decedent relinquished both the economic benefits of the transferred property and the control of those benefits. Given these considerations, it is highly recommended that a strong governance structure be established to monitor the transferor's relationship to previously transferred property in order to mitigate the estate inclusion risk.

A related but separate concern is that lifetime transfers will result in unproductive heirs. Many wealthy individuals believe that their children are unaware of the family's wealth and that lifetime transfers of wealth will act as a disincentive, permitting the children to be less productive members of society.

Effective planning can address these issues, but it requires striking a fine balance in order to satisfy the senior generation's concerns about the ability to achieve the desired financial and nonfinancial goals. For example, where a family business is included in a family's holdings and the senior generation seeks to maintain decision-making authority, value may be transferred to junior generation family members through the use of nonvoting (or low-voting) interests. Further, assets transferred to the junior generation are often placed in trust, and the dispositive terms of those trusts can be thoughtfully crafted to address a particular family's goals and objectives.

The wealth transfer planning process

The wealth transfer planning process:

1 **Identify what is important to you**
- **Identify your needs**
- **Quantify your aspirations**
- **Define your goals**

2 Define your approach to planning

3 Decide how you will distribute your wealth

4 Keep your plan current

1

Identify what is important to you
However you choose to approach your wealth transfer plan, taking incremental but meaningful steps employed through flexible structures will allow your plan to evolve over time.

Upon your passing, your assets must be distributed to your family and friends, philanthropy, or to the government in the form of taxes. If you plan, over time there will likely be more assets transferred to family, friends, and/or the charities of your choice.

The first step is to determine to what extent that is important to you and what limits, if any, might be important to impose. For example, is there a limit to the wealth you wish to leave for family?

Second, does your plan accommodate your heirs' special considerations? For example, are there special needs family members for whom long-term care may be an issue? There are trusts specially designed to address these concerns. How much is needed to endow these trusts can be objectively evaluated.

Third, does the nature of your wealth require special considerations? Whether to retain a successful business enterprise or see to its orderly disposition should not be ignored. If the business is particularly sensitive to your unique contributions, its monetization during your lifetime must be considered.

Fourth, are you passionate about a specific charity? Many individuals build connections to charities through their own active involvement or a common passion for a particular cause, and have a strong desire to leave a portion of their wealth to such organizations. Your testamentary documents become particularly important if you have a closely held business and anticipate that the residue of your estate will pass to charity.

Most people can paint the landscape above in broad strokes, but struggle with the details. That's not a problem. Clear articulation of detailed goals is not required to get started; instead, start by taking incremental but meaningful steps employed through flexible structures to address the goals you can identify now.

The wealth transfer planning process

The wealth transfer planning process:

1 Identify what is important to you

2 **Define your approach to planning**
- **Determine risk tolerance**
- **Collaborate with advisers**
- **Develop a wealth and tax approach**
- **Consider asset protection plans**

3 Decide how you will distribute your wealth

4 Keep your plan current

2

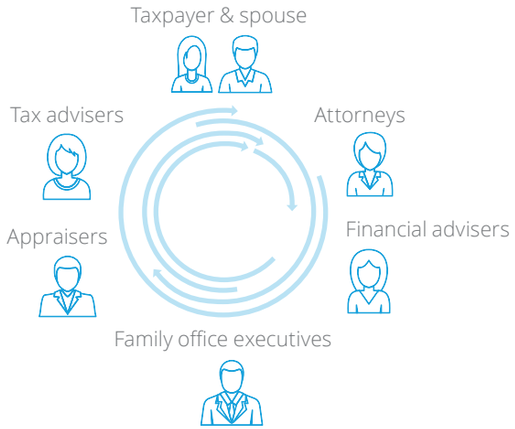
Define your approach to planning
The best estate plans are a collaborative effort. Meaningful advice from knowledgeable, experienced advisers reasonably reflected in the documents implementing the plan is the desired outcome.

Enhanced flexibility inherently increases complexity and may increase risk. More complex transfer planning options can often provide the flexibility to respond to post-initiation changes in circumstances to better serve the family's interests and the ability to transfer more wealth more tax efficiently. However, added flexibility in the hands of the transferor risks asset inclusion, as previously discussed. Thus, prior to implementing such options, two considerations should be addressed. First, do you have an infrastructure in place that will help you navigate the complexity (for example, a family office)? Second, does the plan fit your level of risk tolerance? Certain options may attract greater scrutiny by federal or state tax authorities, particularly with respect to your post-initiation involvement.

Your team of advisers is there to help you assess these considerations and select the right tool(s) for the identified task. For those with significant wealth, an advisory team usually includes legal representatives, officers of the family office, financial advisers (including appraisers and life insurance agents), and tax advisers.

Assembling your planning team
Your planning team may assist in many areas, including:

- Addressing family goals and objectives
- Drafting and interpreting planning documents
- Asset governance structures
- Valuation of certain assets
- Retitling of certain assets
- Determining projected tax liabilities
- Analyzing liquidity posture during life and at death
- Filing necessary tax returns and disclosures



The wealth transfer planning process

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Define your approach to planning (cont.)

The more wealth involved, the more complex the relationships and the more advisers will typically be involved. The more input, the more ideas that may result—but in the wrong situation it may also produce more pressure. At a minimum, planning must involve the wealth owner (and his or her spouse or partner, if they are of like mind), as well as capable counsel and tax and investment advisers. Where a couple is involved, it is not uncommon for attorneys to interview both individuals separately to validate that they are both able to express their views and interests openly. Beyond that, you will need to consider family dynamics and relationships. At the appropriate time, you will need to involve the next generation and others in a position of trust—such as designated fiduciaries (executors, personal representatives, trustees, agents, etc.)—to communicate and confirm their understanding of your wishes and expectations.

As with many aspects of estate planning, there is no one-size-fits-all formula for choosing the right fiduciary; much depends on the size and complexity of your estate. Many wealthy families opt for a combined corporate/individual co-trusteeship—including an individual who understands the family dynamics and interests (such as the need to treat a certain child's bequest differently from others) and a corporation that professionally approaches trust administration. Having one capable individual who may fulfill both roles offers some advantages, but keep in mind that when one family member is in a position of making decisions on behalf of other family members, there may be conflicts. In these cases, trust documents may be drafted to help reduce personal fiduciary liability for contests regarding a trustee's actions and restraints may be imposed on beneficiaries to reduce the probability of such contests.

The wealth transfer planning process

The wealth transfer planning process:

1 Identify what is important to you

2 Define your approach to planning

3 **Decide how you will distribute your wealth**

- **Determine to whom, when, and under what circumstances**
- **Evaluate wealth transfer plans**
- **Implement and monitor the chosen plans**

4 Keep your plan current

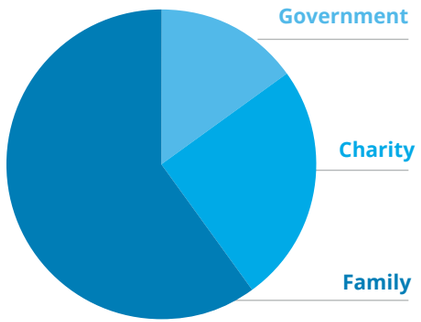
3

Decide how you will distribute your wealth

In the end, however, it's still about who gets what, when they get it, and how they get it.

In some instances, you may want your heirs or charity to have immediate access, control, and enjoyment of the assets you transfer to them, whether by gift or bequest. In other instances, you may consider placing constraints on your heirs' ability to access wealth. Many individuals transfer assets to trusts so that a third party (either an individual, corporate trustee, or private trust company) can oversee the access to wealth by the trust beneficiaries. Establishing trusts to hold, manage, and invest assets—rather than giving individuals complete control over assets—is commonly the key to maintaining family wealth over multiple generations.

Remember that when you transfer assets to a trust or an individual during your lifetime, you no longer have control over or access to those assets if you intend for them to be removed from your taxable estate. Consequently, it is paramount that you assess with your advisers the wealth required to maintain the lifestyle you desire before transferring large amounts of wealth beyond your control.



The wealth transfer planning process

The wealth transfer planning process:

1 Identify what is important to you

2 Define your approach to planning

3 Decide how you will distribute your wealth

4 **Keep your plan current**

- **Perform regular performance reviews**
- **Adjust planning in light of life events and market conditions**

4

Keep your plan current

Routine reviews of your wealth transfer plan allow you to verify that the strategies remain relevant to your goals and objectives.

Once you have a plan in place, it is a leading practice to review your plan with your advisers on a regular basis. There will be market and regulatory factors and life events that will occur, some with little or no warning. Such events may require that you reevaluate your plan, determine whether and to what extent your goals have changed, and suggest actions required to address the change in goals—much like where we started at step 1.

Exercising a little discipline by revisiting your plan periodically to address life, market, and regulatory changes means you will know whether you are meeting the goals you have and reduces the risk of having a plan in place contrary to your current goals (for example, inadvertently maintaining a wealth plan that continues to benefit a former spouse). While life events such as marriages, divorces, deaths, or births should prompt an analysis of plans, so too should certain market factors. For example, substantial increases or declines in asset values, sharp changes in the interest rate environment, and major tax law changes can be significant enough to warrant reviewing your wealth plan.

Many individuals have taken the step to quantify "who gets how much" based on the existing estate plan should the individual unexpectedly pass, including assessing the impact of federal and state taxes. Such an analysis tests the expected outcome of the plan against the mathematical computation dictated by the written word in the estate plan. From such reviews, additional considerations may arise and ambiguities in the wealth transfer plan may be identified, both of which may require further clarification. Thereafter, regular analysis provides the opportunity to monitor your plans against expected outcomes, reassess the continuing relevance of your goals and objections, and mark your progress in prefunding wealth transfer strategies in light of a changing regulatory environment and a volatile economy.

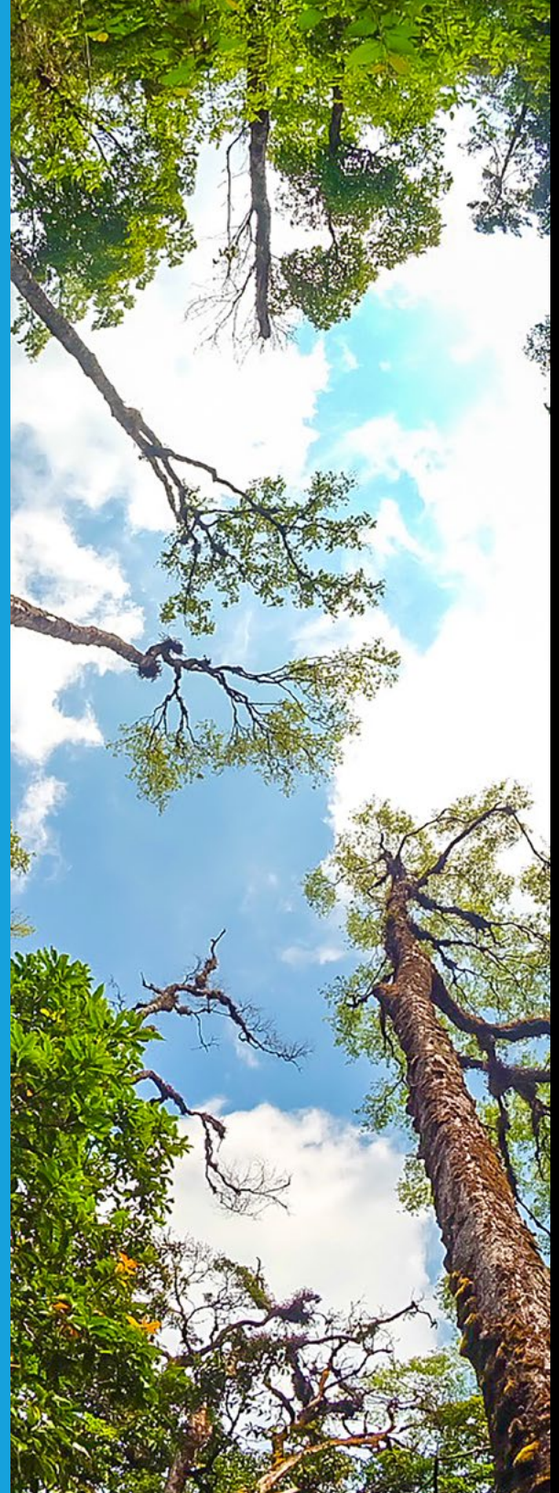
Wealth transfer planning

Take another look

Regardless of the planning you undertake, a periodic reassessment is wise. Perhaps the complexity of your assets has grown. Perhaps a new executor or trustee designation is appropriate. Maybe the children are not really "children" anymore and their needs and abilities have evolved. Or perhaps you have decided to undertake a new philanthropic initiative. Whatever the reason, chances are it's time to take another look at your wealth transfer plan.

Philanthropy

Your legacy is not only how you want to be remembered, but should also comprise a set of guiding principles your family will be encouraged to uphold. Fashioned by lifetime actions and contributions, as well as testamentary bequests, your legacy planning may take many forms and be driven by multiple factors: a desire to support philanthropic pursuits about which you are passionate, a wish to provide a way for family and friends to remember you, or an aspiration for a mechanism to connect future generations. If you intend to build your legacy through charitable efforts, you may also recognize tax benefits. In the current legislative environment, the path to tax-efficient charitable planning is winding and complicated.



Home

Menu

Back

Forward

Charitable giving considerations

Although you may be able to offset income or estate tax with a charitable deduction, the tax deduction alone is not usually the deciding factor in making a donation.

Often, a tax deduction for charitable contributions is not the driving factor for a philanthropist, but it does enable the charitably inclined to give more. Even philanthropists focused on the intrinsic value of a donation to charity may seek to benefit the greater good in a more tax-efficient manner.

There are many options to help accomplish your charitable objectives and preserve tax efficiency. However, pitfalls exist that may reduce or totally eliminate the tax benefit received from charitable transfers. Prior to making a donation or charitable pledge, it is critical that you take time to understand the rules affecting the amount and timing of your deduction, as well as the steps that must be taken to protect the deductibility of your contribution.

Each time you review your charitable giving plan, consider the following questions:

With how much wealth am I willing to part?	What type of assets do I have at my disposal?	How much control do I want?	What is the desired income stream for me, my family, and my charity?
What percentage of my income do I want to spend on philanthropy?	Do I anticipate an income event that will enhance or limit the benefit I receive from a charitable donation?	When does the charity need the funds to meet both my goals and its own?	What is my desired timing for receiving an income tax deduction for the charitable gift?

Charitable planning: A primer

The choices you make with respect to the type of charitable organization recipient and type of property you contribute will directly impact the amount of charitable deduction available to you. As shown in the chart below, you are allowed a deduction in the year of donation of up to 50 percent of your adjusted gross income (AGI). Any excess charitable contributions can be carried forward for five years. The 20, 30, and 50 percent AGI limitations continue to apply in those future years. Additionally, in any subsequent year, the current-year contributions must be claimed before any carryovers can be considered. If carryovers involve more than one year, a first-in, first-out principle is applied.

Let's look at a quick example of how donor's choice of donee organization and donated property can impact the donor's charitable deduction. Assume an art enthusiast donates a painting held for many years that has appreciated in value to a local museum (a public charity). If the museum routinely displays such works of art, then the donation would likely be considered a donation of tangible personal property put to a use related to the museum's charitable purpose or function. In this case, there is a donation of long-term capital gain property, and the amount of the contribution would be based on the fair market value (FMV) of the painting and the amount of the deduction would be subject to the 30 percent AGI limitation.

If instead the painting was contributed to a local church for ultimate disposition in a live auction, it would be considered a donation of long-term capital gain property, but the donation would also be subject to a special rule for tangible personal property *not* put to a use related to the charitable organization's purpose. In this case, the amount of the contribution would be based on the donor's adjusted cost basis of the painting (or FMV, if lower) and the amount of the deduction would be subject to the 50 percent AGI limitation.

Type of property contributed	Type of donee organization			
	Public charities (or private operating foundations, and certain private nonoperating foundations)		Private foundations (or other organizations that do not qualify for public charity deduction treatment)	
	Contribution amount	**Deduction limited to**	**Contribution amount**	**Deduction limited to**
Cash	Cash	50% AGI	Cash	30% AGI
Ordinary income property	Adjusted basis*	50% AGI	Adjusted basis*	30% AGI
Short-term capital gain property	Adjusted basis*	50% AGI	Adjusted basis*	30% AGI
Long-term capital gain property	FMV	30% AGI	Adjusted basis*	20% AGI
Long-term capital gain property (qualified appreciated stock)			FMV	20% AGI
Long-term capital gain property (tangible personal property put to unrelated use)	Adjusted basis*	50% AGI		
Long-term capital gain property (reduced deduction elected)	Adjusted basis*	50% AGI		

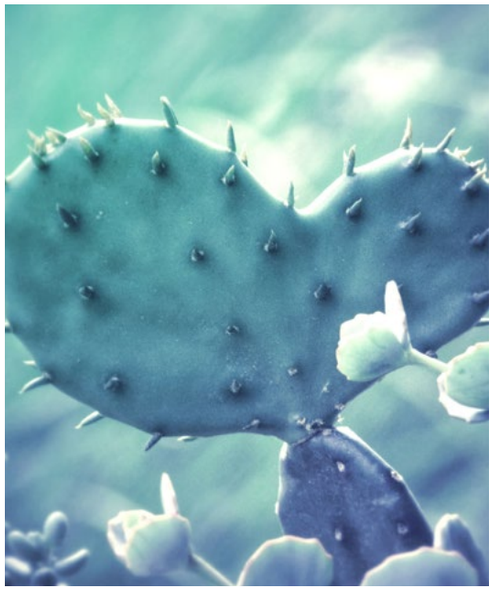
* Or FMV, if less.

Home
Menu
Back
Forward

Charitable planning: A primer

Gifting cash versus appreciated stock

It may be more tax efficient to donate appreciated securities held for more than one year rather than cash. If you donate securities, then you not only receive a charitable deduction equal to the FMV of the securities contributed, but you also avoid paying capital gains tax on the stock's appreciation, as well as the 3.8 percent net investment income tax. By preserving the cash, you could purchase new investments with a "refreshed" higher basis. However, even knowing these rules, if you do not wish to surrender a particular security, then you may choose to donate cash despite the potential for a less efficient tax result.



Impact of Pease limitations

Sometimes large donations do not carry forward but are completely eliminated by an overall phaseout of your itemized deductions. The Pease limitation, named for its author, Representative Donald Pease (D-Ohio), requires higher-income individuals to reduce the total amount of most itemized deductions allowed. Under current income tax rates, depending on facts and circumstances, the value of a deduction may range from 39.6 percent to only 4 percent in tax dollars saved. The chart below summarizes the impact of the Pease limitation on the total itemized deductions allowed.

Pease limitation is equal to the lessor of:

3% of AGI over the applicable threshold
80% of itemized deductions

2017 thresholds:

$261,500 for single filers
$313,800 for joint filers

Limitation applies to:

Deductions for taxes
Mortgage interest expense
Charitable contributions
Miscellaneous itemized deductions

Limitation does not apply to:

Investment interest expense
Casualty losses
Medical expenses
Gambling losses

While you may desire to make an immediate gift, a tax adviser may assist by projecting the deductibility over time for increased efficiency of the deduction. This critical information will help you to determine how to achieve your desired philanthropic goal at a mutually agreeable time for both the charity and you.

You want to make a one-time charitable contribution of $200,000 to your alma mater. Should you make it this year or next year?

Let's run the numbers:

	2017	2018
Wages	$3,000,000	$3,000,000
Qualified dividends	$500,000	$500,000
Long-term capital gains	$0	$6,000,000
Charitable contributions	?	?
Other deductions	$125,000	$125,000
Income tax with no contribution	$1,264,654	$2,694,131
Income tax with $200,000 contribution	$1,185,454	$2,676,771
Tax savings	$79,200	$17,360
% Benefit	39.6%	8.68%

In the above scenario, making the contribution in 2017 results in more tax savings.

Complex asset contributions

Unique rules apply to contributions of complex assets.

Partnership interests

Charitable gifts of partnership interests are inherently more complicated than gifts of publicly traded securities.

A donation of a partnership interest may result in issues for the charity that should be anticipated. For example, a charity may be less willing to accept an interest in a partnership that will produce taxable income not substantially related to the exercise or performance of its charitable, educational, or other purpose or function constituting the basis for its exemption. This is called unrelated business taxable income (UBTI). Unless the charity can be assured of receiving sufficient cash distributions from the partnership to pay the resulting tax liability on the UBTI, it may not be willing to accept the gift.

If you contribute a partnership interest, such as an interest in a fund, to a public charity, you will generally receive an income tax deduction equal to the FMV of the property, assuming it is long-term capital gain property. If the partnership interest has a value greater than $5,000, an appraisal will be required to substantiate the contribution.

Additionally, you should consult with a tax adviser regarding whether there may be a deemed sale related to partnership debt allocated to you and if the amount of the charitable deduction may be reduced to the extent of ordinary income recapture on the partnership interests transferred. Unlike in noncharitable situations where there may be no gain depending on whether your basis exceeds the debt at issue, a transfer to a charity almost invariably gives rise to gain because the donor's basis must be allocated between the charitable portion and the sale portion. If you are considering donating a partnership interest with associated suspended passive losses, then you may want to consider selling the interest, recognizing the suspended loss, and making a charitable gift of the sale proceeds.

There are additional issues beyond the scope of this discussion that may be encountered when donating a partnership interest to a nonoperating private foundation.

Individual retirement accounts (IRAs)

If you are age 70½ or older, you may consider gifting a contribution from an IRA to an eligible charitable organization. These contributions are not subject to the above limitations in certain circumstances. You may transfer up to $100,000 annually (or up to $200,000 if married filing jointly and each spouse contributes from their respective IRAs) directly from the IRA trustee to the eligible charity and exclude the amount from taxable income. A state income tax benefit is also possible as many state forms rely on federal AGI (sometimes modified). Thus, if your AGI is lower with a qualified charitable deduction from an IRA than it would be by withdrawing from the IRA and then making a donation, there is a possible state tax benefit too. Distributions from employer-sponsored retirement plans, including simplified employee pension plans, are not eligible. If these IRA requirements are met, then you do not include the amount of the distribution as taxable income. However, you do not receive a corresponding charitable deduction for the amount transferred to charity.

Complex asset contributions

Great care should be taken with any conservation easement transaction.

Conservation easements

If you have a particular piece of land in mind with specific conservation objectives, you may consider a conservation easement that would allow you to keep ownership and control while those objectives are achieved. Note that great care should be taken with any conservation easement transaction as this is an area of careful scrutiny by the IRS.

A conservation easement gives power over the land to a qualified private land conservation organization, sometimes called a "land trust," or a government municipality to constrain the owner's use of the land to achieve certain conservation purposes.

A qualified appraiser must determine the value of the easement donation. For income tax purposes, the value of the donation equals the difference between the FMV of the property before and after the easement takes effect. For estate tax purposes, the deceased's estate will be reduced by the value of the donated conservation easement. As a result, taxes will be lower because heirs will not be required to pay taxes on the extinguished development rights. The conservation easement "runs with the land," meaning it is applicable to both present and future owners of the land. As with other real property interests, the grant of a conservation easement is recorded in the local land records and becomes part of the property's chain of title.

Art and antiques

You may want to gift art or an antique to a cultural institution. It is important to analyze and implement appropriate donation strategies, consult on related-use requirements, and review appraisal requirements for income and transfer tax returns. Additional considerations may include fractional donations and charitable remainder trusts. As mentioned previously, for art and other tangible personal property with a long-term holding period, the charitable deduction is FMV only if the property will be put to a use related to the exempt purpose of the charity. A more detailed discussion of these rules will be provided in the "Unique assets" section of the third installment of the 2018 essential tax and wealth planning guide (to be issued in early 2018).

Charitable giving requires attention to detail

Timing matters

Simple issues with timing may create a risk of being denied the donation in the current year or at all. Generally, timing for charitable donations follows the "mailbox" rule, which means that if the check is in the mail on December 31 of a given year and the check is cashed within a reasonable amount of time thereafter, then you may deduct it. Similarly, for donations charged on credit cards on or before December 31, the payment of the charge can occur in the following year. For gifts of securities, the security must have been transferred out of the donor's brokerage account by close of business on December 31. For gifts of real estate, state law will control when the donation became effective, but the transfer will likely need to be recorded before the end of the year. For other assets, state law will control. You should consider consulting with legal counsel regarding whether they can provide an opinion about the effective date of complex, last-minute donations.

The timing rules create a higher risk that deductions may be lost when the timing of an asset donation relates to an imminent liquidity event. The issue to be considered is whether you must still recognize the income pursuant to the assignment of income rules. A gift of appreciated property will generally not result in income to the donor so long as he or she gives the property away entirely before the property gives rise to income by way of sale. Many last-minute donations are not at risk, especially if they are simply a donation of stock followed by a public sale of the stock by the charitable donee. However, in more complicated cases, such as a corporate redemption, you should seek counsel as to whether or not the donation may be made without the donor having to recognize the income.

Contribution recordkeeping and substantiation

When making donations, you should consult with tax advisers regarding the recordkeeping requirements necessary to sustain the charitable income tax deduction. For a monetary gift of any amount, either a written record (such as a credit card statement or canceled check) or a written contemporaneous acknowledgment from the charity is required. For donations of $250 or more, a written acknowledgment from the charity is required, stating the amount of any benefits received in return for the donation. In this circumstance, a canceled check is not sufficient to support the deduction, nor is an acknowledgment received after a tax return has been filed. These rules apply even if the donation is made to your own family foundation. The acknowledgment letter from the charity must include any benefits received from the donation. If none are received, the acknowledgment letter must say so.

Charitable giving requires attention to detail

When property other than cash, inventory, and publicly traded securities is donated to charity and such property is valued above $5,000, the property must be appraised and summarized on the donor's income tax return to claim a charitable deduction. If the value exceeds $500,000 ($20,000 for artwork), the appraisal must be attached to the donor's income tax return, whether the donor is an individual, partnership, or corporation.

The chart below summarizes documentation requirements for various types of donations. As shown in the chart on the next page, the devil is in the details. Deductions for otherwise proper charitable contributions have been lost for seemingly minor omissions from these documents, for example: a letter from a charity that does not have the requisite language regarding whether any goods or services were provided, a Form 8283, Noncash Charitable Contributions, with the donor's cost basis information omitted, or a missing appraisal that was required to be attached to the tax return.

Do you have the required documentation to support your contribution?

		Documentation required				
Type of property contributed and amount of contribution		Record of contribution	Contemporaneous written acknowledgment	Form 8283, Section A	Form 8283, Section B	Qualified written appraisal***
Cash and unreimbursed out-of-pocket expenses	< $250	●				
	$250 +		●			
Public securities	Any amount*		●	●		
Other noncash property	Items** for which deduction is $5,000 or less*		●	●		
	Items** for which deduction is > $5,000		●		●	●

* If total deduction for all noncash contributions is > $500.

** Or group of similar items

*** Certain appraisals may be required to be attached to the tax return.

Charitable giving requires attention to detail

Do your supporting documents contain the necessary items?

Items that must be included	Documentation required: Record of contribution*	Contemporaneous written acknowledgment	Form 8283, Section A	Form 8283, Section B**	Qualified written appraisal***
Name of donee organization	●	●	●	●	
Address of donee organization			●	●	
Date of contribution	●	●	●	●	●
Amount of cash contribution	●	●			
Description of any noncash contribution		●	●	●	●
Description of condition of tangible property contributed			●	●	●
Date contributed property was acquired by donor			●	●	
How contributed property was acquired by donor			●	●	
Cost or other basis in contributed property			●	●	
FMV of contributed property			●	●	●
Method of arriving at FMV of contributed property			●		●
Statement as to whether goods or services were provided in return by donee organization		●			
Description and estimate of the value of goods or services provided by donee organization		●			
If donee organization provided any intangible (religious) benefits, a statement to that effect		●			
Name, address, and identifying number of the qualified appraiser				●	●
Declaration of appraiser, including signature				●	●
Donee acknowledgment, including signature				●	

* Canceled check, or receipt, or letter from donee organization

** Separate Form 8283, Section B required for each donee and each item of property (or group of similar items)

*** A separate qualified appraisal is required for each item of property that is not included in a group of similar items of property. A qualified appraisal must meet additional requirements as specified in the regulations.

Charitable giving requires attention to detail

All of these factors—type of asset, type of charity, timing of the donation, and recordkeeping—make planning for a philanthropic goal complicated. Strict adherence to tax rules is not necessary to benefit the common good. However, it may indeed be possible for you to receive the simultaneous benefit of feeling that you have made an impact on the goals of the charity while also making an impact on your overall tax burden. In the end, if the gift is made in a more tax-efficient manner, then you will have more assets remaining to be able to achieve future philanthropic goals. Therefore, it is extremely important that you plan ahead—perhaps years in advance—to achieve your intended goals.

Disaster relief

Contributions to assist domestic and foreign natural disaster relief efforts

Recent natural disasters, including earthquakes, hurricanes, and wildfires, have resulted in substantial damage in California, Puerto Rico, the US Virgin Islands, Mexico, the Dominican Republic, and other locations. You may wish to donate to charitable organizations to aid relief efforts; however, the deductibility of such contributions may depend on the choice of charitable organization, the stipulated use of the funds, and other factors.

Generally, charitable deductions are available for contributions to charities created or organized in, or under the laws of, the United States or its possessions, which includes the Commonwealth of Puerto Rico and the US Virgin Islands.

Gifts to domestic charities for foreign relief

If you want to make a contribution to relief efforts in a foreign country, then you need to ensure that your donation will be deductible. Generally, contributions to domestic charities that transfer the donated funds to a controlled foreign subsidiary *are* deductible. However, you should take care to donate to the domestic organization (as opposed to a direct contribution to the foreign subsidiary).

The IRS provides an Exempt Organization Select Check search tool to help taxpayers identify qualified organizations. Organizations on this list with foreign addresses are generally not foreign organizations, but are domestically formed organizations carrying on activities in foreign countries. These organizations are treated the same as any other domestic charity with regard to deductibility limitations.

Gifts to foreign charities

Contributions made directly to foreign charities are generally *not* deductible. Exceptions to the general rule are as permitted by certain tax treaties between the United States and specific countries. For example, the United States–Mexico Income Tax Convention allows for reciprocal recognition of the tax-exempt status of each country's charities and the allowance of tax deductions for contributions to such organizations; however, the amount of the deduction will be limited to your Mexican sourced income. There is no such treaty in place with respect to the Dominican Republic and other Caribbean nations.

Gifts to donor-advised funds

Alternatively, if you have a specific design for your contribution, a donor-advised fund may be a suitable cross-border charitable vehicle. A donor-advised fund (discussed later) is sponsored by a public charity, and therefore would allow you to make a tax-deductible contribution in the initial year and then recommend grants over time to any IRS-qualified public charity.

Gifts to individuals

You may wish to donate money or property to help affected family members, friends, and colleagues directly. If so, then remember that donations of money or property to help another individual generally constitute a gift. Such a gift does not qualify as an income tax-deductible charitable contribution because the recipient is not a qualified charitable organization.

Fraudulent charities

Criminals may look to take advantage of your generosity by attempting to collect personal information or money from you. Be vigilant when donating and providing information to charities.

Disaster relief

Extra tax benefits for qualified contributions made between August 23, 2017, and December 31, 2017

If you have made or will make gifts to qualified charities for certain types of disaster relief during this time frame, then you may be able to offset more of your income with a charitable deduction than is normally allowed. The recently enacted Disaster Tax Relief and Airport and Airway Extension Act of 2017 provides:

- A temporary suspension of the 20, 30, and 50 percent AGI limitations with respect to qualified contributions. Instead, qualified contributions are allowed up to the amount of an individual taxpayer's AGI (before any applicable net operating loss carryback) less all nonqualified contributions allowed under the normal rules.
- A temporary suspension of the Pease limitation (discussed earlier) with respect to qualified contributions.
- Excess qualified contributions may be carried forward up to five years.
- Qualified contributions are not taken into account for purposes of applying the AGI limitations and the charitable contribution carry forward rules to nonqualified charitable contributions.

"Qualified contributions" are generally charitable contributions that meet the following requirements:

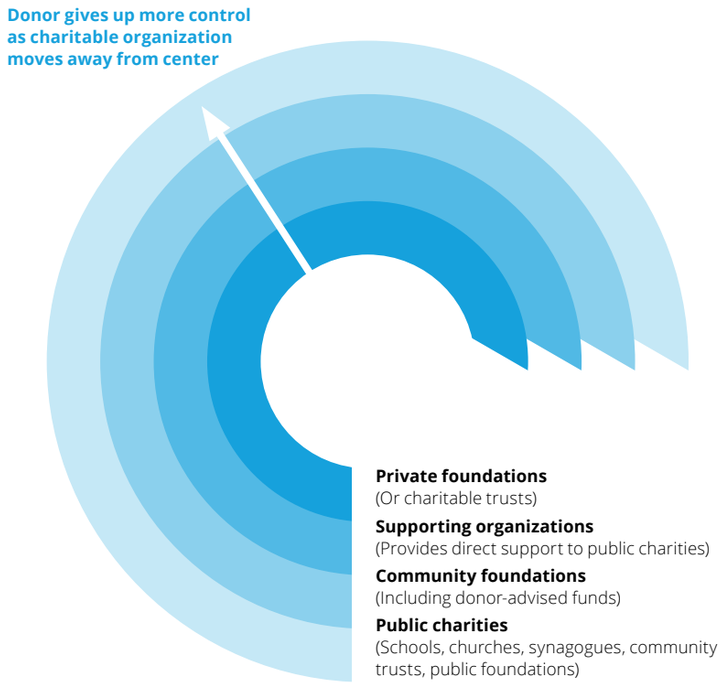
1. Paid in cash;
2. Paid during the period beginning on August 23, 2017, and ending on December 31, 2017;
3. Paid to a charitable organization (except not a supporting organization or a donor-advised fund);
4. Made for relief efforts in the Hurricane Harvey disaster area, the Hurricane Irma disaster area, or the Hurricane Maria disaster area;
5. Supported by contemporaneous written acknowledgment stating that such contribution was used (or is to be used) for such relief efforts; and
6. The taxpayer elects to apply the special rules on his or her tax return.

If you would like to plan for any of these special considerations, contact your tax adviser to make sure that you follow the guidelines and obtain the required documentation in a timely manner.

Matching your charitable vision to the right planned giving strategy

For those pursuing tax efficiency, there are many areas that require thoughtful consideration: the type of asset to donate, the timing of the gift, the vehicle to use to fund the gift, and the type of organization to receive it.

If you wish to engage in more complicated planning, it may be possible to maintain partial control over an asset being contributed to a charity or, in limited situations, to maintain a cash-flow stream from the asset. If control is your primary concern, then using a vehicle such as a donor-advised fund or a private foundation may be appropriate. However, if a cash flow stream is desired, then a split-interest charitable trust may be more advisable.



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The chart below summarizes the factors you should consider when evaluating where to contribute assets.

Planned giving options	Private foundation	Donor-advised fund	Public charity
Deductible contributions?	Yes	Yes	Yes
Contribution limit? (Generally, exceptions apply)	30% of AGI for cash contributions 20% of AGI for noncash	50% of AGI for cash contributions 30% of AGI for noncash	50% of AGI for cash contributions 30% of AGI for noncash
Donor controls grant making?	Yes	No, but donor can advise	No
Donor controls investment decisions?	Yes	No. Donor may choose investment plan, but sponsoring organization has control	No
Donor manages operations and administers organization?	Yes	No. Donor pays a fee to sponsoring organization to provide administrative services	No
Annual distribution requirements?	Yes (5% of FMV of noncharitable use assets)	No	No
Organization subject to income/excise tax?	Yes (1% or 2% excise tax on net investment income and an income tax on unrelated business income)	No, unless there is unrelated business income	No, unless there is unrelated business income
Organization subject to excise tax for prohibited actions?	Yes. Potential excise tax due for engaging in acts of "self dealing," having "excess business holdings," and making "jeopardizing investments" or "taxable expenditures"	Yes. Potential excise tax on excess business holdings, taxable distributions, and excess benefit transactions	Generally, no (potential excise tax on political activities)
Organization required to file an annual tax return?	Yes (Form 990-PF)	No. An annual filing by sponsoring organization, not each separate donor-advised fund	Yes (Form 990)

Matching your charitable vision to the right planned giving strategy

Private foundation

A private foundation is formed to administer the charitable interests of an individual or family, according to their wishes. Income tax deductions are generally less favorable than those to public charities. You would receive a charitable deduction subject to the 30 percent AGI limit for contributions of cash. If you are donating appreciated securities or assets, you would be subject to the 20 percent AGI limit and the value of your deduction would generally be your adjusted basis unless it was a donation of "qualified appreciated stock." You would not retain any rights to the assets, but could retain certain rights to administer the foundation, subject to the self-dealing rules. Some donors prefer a private foundation because it allows them or their family more control over giving. A private foundation can be used to "pre-fund" several years of normal charitable giving. Private foundations can also be used to give assets that are not easily divided, such as real property, or provide a means to fund foreign charitable endeavors. There is a minimum annual asset distribution requirement.

While a private foundation may be a significant part of the legacy you leave and the vehicle that brings your family together after your passing, you should consider the administrative complexities of maintaining a private foundation when you assess whether it is the right vehicle for you.

Donor-advised fund (DAF)

A DAF is a fund that is managed under the tax umbrella of a public charity such as a community foundation. You would make an irrevocable gift of property (such as stock held for greater than one year) to the host charity and receive a tax deduction equal to the FMV of the property in the year of the gift. Assets are deposited into an investment account where they can grow tax free. Only one acknowledgment letter for the donation to the fund is required instead of one receipt from each charity receiving a donation from the DAF, which can significantly simplify recordkeeping for tax purposes. You retain the right to advise, but not to direct, the host charity in administering the affairs of the DAF.

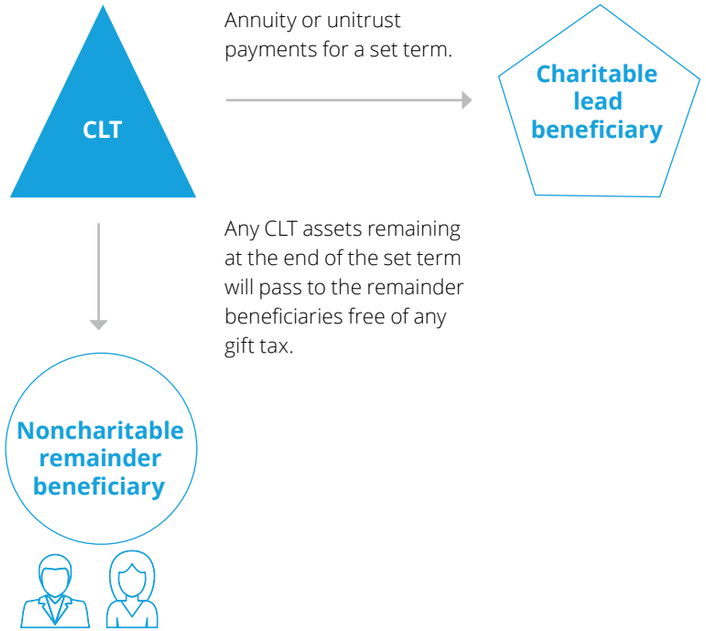
Depending on the policies of the host charity, advice may include naming the fund, managing investments, recommending grants, and selecting a replacement adviser at the death of the donor. DAFs cannot benefit you directly or any other private interest.

Matching your charitable vision to the right planned giving strategy

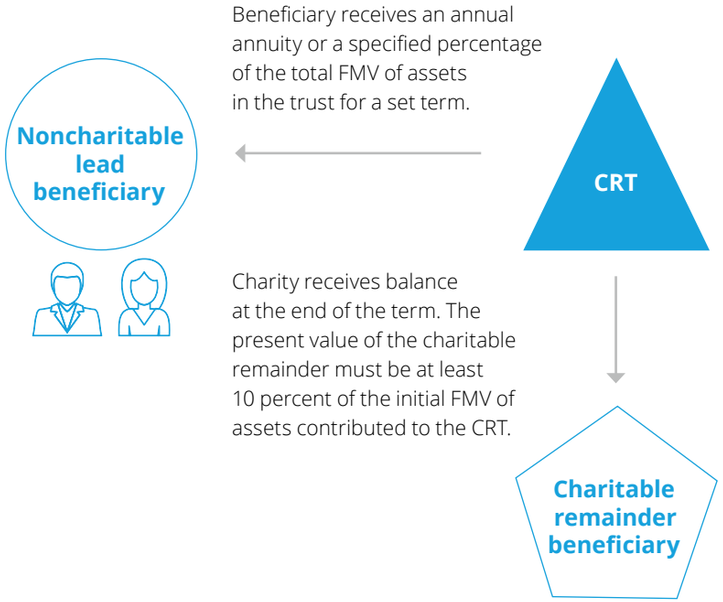
If a cash flow stream is desired, either prior to or after the asset is transferred to charity, then a split-interest charitable trust may be a tax-efficient alternative to transfer the asset. The financial interest from these trusts is split between the charitable and noncharitable beneficiaries (including the donor). The two most common kinds of split-interest charitable trusts are a charitable lead trust (CLT) and a charitable remainder trust (CRT). Both of these trusts are related, but they are fundamentally different.

The CLT will make distributions to a charity for a particular amount of time. After that, the assets within the trust, which are called the remainder interest, will pass to desired noncharitable beneficiaries. With the CRT, the assets placed within the trust will provide distributions to the noncharitable beneficiaries (typically the donor) for a certain time period or the lives of the beneficiaries. The assets will then become property of the charity. These two trusts are inverses of one another and are taxed in significantly different ways.

Charitable lead trust (CLT)



Charitable remainder trust (CRT)



Matching your charitable vision to the right planned giving strategy

Charitable lead trust

A CLT can be designed to pay in two different ways: as a fixed annuity payment or a unitrust amount to the charity. This means that the charity can be paid a fixed dollar amount annually or a fixed percentage of the FMV of the assets in the trust. A CLT may be useful when the asset being contributed has a high potential for future appreciation. It may also be appropriate if your heirs are still young and not capable of assuming control of a substantial amount of assets. In creating and funding a CLT, you would make final arrangements for the disposition of the assets by your estate but defer the time when your beneficiaries can actually take control of and receive property. In the interim, the charity receives ongoing and immediate benefit from the trust. When assets do eventually pass to the beneficiary or beneficiaries, they are not subjected to federal gift tax. Timing and recipient of the charitable deduction depends on the terms of the trust.

Charitable remainder trust

Alternatively, a CRT will first pay the beneficiary, which could be yourself, before the remaining assets are permanently awarded to the charity. Like the CLT, the payment to the beneficiary can be an annuity, which is a fixed dollar amount, or a unitrust, which is a fixed percentage of the FMV of the assets in the trust. The amount distributed each year must be set at the creation of the trust to be at least five percent of the initial FMV of the trust assets. A CRT may be a good planning option if you have an appreciated asset that you would like to sell and diversify, but desire to be able to defer the gain over time. Income is taxed only when distributions are made from the trust (assuming there is no UBTI).

You would receive a charitable deduction in the year of transfer equal to the remainder value for the charity, which must be at least 10 percent of the amount contributed.

CLTs are useful for donors who:

- Have sufficient other income-producing assets to provide for their cash needs during the charitable term

CLT benefits

- May assist when contributions exceed charitable AGI limits
- Allows a donation to charity while keeping assets in the family
- Helps mitigate gift/estate taxes

CLT drawbacks

- No income tax deduction for grantor unless CLT is a grantor trust
- Requires charitable payment each year regardless of income
- Subject to some private foundation rules

CRTs are useful for donors who:

- Require a current income stream
- Desire to defer large capital gain
- Anticipate having a need for income during the trust term, particularly if the donor uses appreciated property to fund the trust

CRT benefits

- Charitable contribution deduction is allowed for the present value of the remainder interest of the trust
- Provides annual payout to noncharitable beneficiary
- Allows for deferral of gain on assets to be sold

CRT drawbacks

- Irrevocable—may not be changed
- Limited on types of assets in which to invest
- Subject to some private foundation rules

Philanthropy

Planning for philanthropic goals

Charitable contributions are often the largest controllable deduction for an individual. For those seeking tax efficiency, there are many areas that require thoughtful consideration: the type of asset to donate, the timing of the gift, the vehicle to use to fund the gift, and the type of organization to receive it.

It is critical to work with an adviser specializing in this area to navigate your way through these decision points effectively for the sake of both your philanthropic goals and your tax planning.

Tax policy update

As this edition of the wealth guide goes to press, separate tax reform bills are moving through the House and Senate that, on the individual side of the code, call for ambitious changes.

Tax reform uncertainty continues

The changes proposed in the current tax reform legislation include a substantial cut in the tax rate imposed on passthrough entities, relief from the estate tax and the alternative minimum tax, and generous increases to the standard deduction and the child tax credit.

Both bills advance the objectives of the tax reform "framework" put forward in late September by a group of congressional Republican leaders and White House officials informally known as the "Big Six." The framework addressed GOP tax policy goals largely in broad strokes, with few details on how various tax relief provisions would operate and how they would be financed.

Although they sometimes take different approaches, the House and Senate bills fill in those blanks by laying out income thresholds for the proposed new individual rate brackets, "guardrails" for the proposed new passthrough regime, and proposals to pare back or eliminate a number of current-law deductions, credits, and incentives.

House and Senate Republican leaders have said they hope to win approval for their respective bills, resolve differences between the two measures in a conference committee, and get a final tax reform package to President Trump for enactment by the end of this year. But as lawmakers face a tight legislative calendar and a pile-up of other end-of-year priorities, some have speculated that action on tax reform could slip into 2018.

Who are the Big Six?

- House Speaker Paul Ryan, R-Wisconsin
- Senate Majority Leader Mitch McConnell, R-Kentucky
- House Ways and Means Committee Chairman Kevin Brady, R-Texas
- Senate Finance Committee Chairman Orrin Hatch, R-Utah
- Treasury Secretary Steven Mnuchin
- National Economic Council Director Gary Cohn

Stay ahead of tax reform and other tax policy developments

An integral part of our Washington National Tax practice, Deloitte's Tax Policy Group provides perspective on the latest corporate and individual tax developments on Capitol Hill.

Tax News & Views

Our Tax Policy Group publishes a regular newsletter called Tax News & Views, which offers clear, concise, and timely coverage of the significant tax developments on Capitol Hill and what they mean for taxpayers.

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About our Washington National Tax practice

Deloitte's Washington National Tax (WNT) practice is a select group of tax specialists whose knowledge, skill, and experience bring world-class insights to our tax leader clients. Our teams include former high-ranking Treasury and IRS officials, congressional staff, state officials, and other professionals with considerable private sector and industry experience. This group uniquely positions Deloitte to help you identify opportunities, respond proactively to changes in the tax environment, and develop adaptable positions for sustainable advantage.

Identity theft

Look again at how you safeguard your personal financial information. While the IRS has made solid strides toward reducing the number of individual and entity identity theft instances, you still need to remain vigilant about your personally identifiable information. In 2018, you should also be prepared for the IRS to be inquiring about new information to assist it in verifying your true identity. Your tax adviser can help you take another look at how to guard yourself from identity theft or how to respond if it occurs.

Home

Menu

Back

Forward

How to protect yourself

The IRS does not initiate contact with taxpayers by phone or email to request personal or financial information. This includes any type of electronic communication, such as text messages and social media channels.

Personal tax-related identity theft

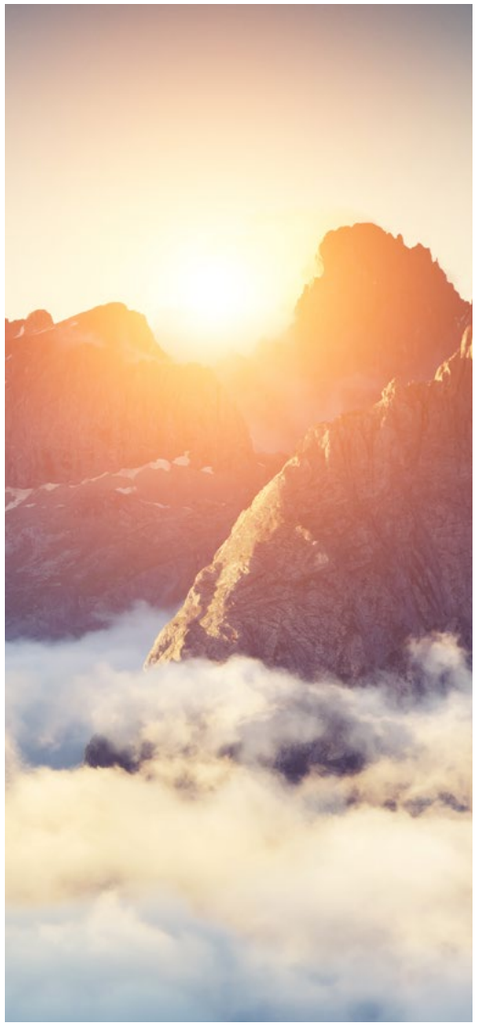
All too often in recent years, a taxpayer goes to file an individual income tax return and finds that, unbeknownst to him or her, a return has already been filed on the taxpayer's behalf. Tax-related identity theft occurs when someone uses your personal information, such as your name, Social Security number (SSN), or other information, without your permission to file a tax return claiming a fraudulent refund. All income levels of the US population have experienced tax-related identity theft. It is typically discovered when you attempt to e-file and learn that a tax return has already been filed with your SSN. This erroneous filing can affect your income tax filing obligations or available credits. It also leaves you open for further fraudulent use of your SSN.

If you believe you are a victim of tax-related identity theft, you should contact the IRS immediately. If you are unsure and would like someone to assist with determining if you have been a victim, then you could also contact your tax adviser. Your adviser can use Form 2848, Power of Attorney and Declaration of Representative, to secure IRS transcripts of your account to determine if the fraudulent return has been processed. If you are a victim, then you should file and submit Form 14039, Identity Theft Affidavit, to the IRS. After receipt of Form 14039 by the IRS, it will be subject to an accuracy review. If accepted and processed by the IRS, the IRS will send you a CP01A Notice with an Identity Protection Personal Identification Number (IP PIN).

Your IP PIN can be used when filing electronic or paper returns. If you do not use your IP PIN, then your electronic return will be rejected and your paper return will be subject to additional screenings to validate your identity, which will delay your refund (if applicable). Each IP PIN can be used only once. Thereafter, a distinct IP PIN will be issued systematically on an annual basis in December. Even if you are a victim, you still must continue to pay your taxes and file your tax returns, even if you must do so by paper. The IP PIN will eliminate any delay in processing the valid tax returns.

Additionally, if you have been subject to identity theft, there are other steps that you can take to protect yourself. You should contact any respective state tax agencies, file a report with local law enforcement, and file a complaint with the Federal Trade Commission (www.ftc.gov/complaint). In general, you should contact one of the three major credit bureaus to place a "fraud alert" on your credit records and monitor your credit reports. If any of your financial accounts have been affected, then you should contact the financial institutions and close them. It is also a good idea to check your Social Security Administration earnings statement annually to reconcile your earnings with what was reported.

How to protect yourself



Warning signs for individuals

- You owe additional tax, refund offset, or have collection actions against you for a year you did not file a tax return
- You receive an unexpected tax transcript or IRS notice that does not correspond to anything submitted by you
- IRS records indicate that you received wages from an employer unknown to you
- You are impacted by a data breach (for example, improper disposal of personally identifiable information in the trash or a sophisticated cyberattack on corporate computers by criminals)
- High risk: data breach of SSN and financial data (such as wage information)
- Low risk: credit card numbers, health records without SSNs, driver's license numbers
- You lost a cell phone
- Your mail was stolen
- You receive confirmation of a change of address when your address did not change

How to mitigate your individual risk

- Do not give a business your SSN just because it asks; only provide this information when absolutely necessary
- Check your credit report annually
- Check your Social Security Administration earnings statement annually
- Protect your personal computers by using firewalls and anti-spam/virus software, updating security patches, and changing passwords for Internet accounts
- Do not give personal information over the phone, through the mail, or via the Internet unless you have either initiated the contact or are sure you know who is asking
- Change all financial account and email passwords on a regular basis

IRS initiatives to prevent identity theft

IRS's new initiatives to stop individual tax-related identity theft

The IRS does not initiate contact with taxpayers by phone or email to request personal or financial information. To reinforce that fact, the IRS started an education series called "Don't Take the Bait," which focuses on vigilance toward computer security and warns about email scams dubbed "spear phishing" in which senders identify themselves as a friend, customer, or company. You should not respond to the IRS via any type of electronic communication, such as text messages and social media channels. Also, remember that the IRS does not call taxpayers with threats of lawsuits or arrests.

If you change your address, then you should expect the IRS to send a change of address letter to both the new address and the old address.

You may also have noticed in 2017 that the IRS and/or state tax agencies asked for your driver's license number or a state-issued identification number. This information is optional for most state tax returns, but a few states do require it to complete the electronic filing process. It is also optional for a federal tax return. However, providing these identification numbers helps the IRS verify your identity, which can prevent unnecessary delays in tax return processing.

In 2018, there will be a new verification code box on all official Forms W-2. Piloted in 2017, the verification code is a 16-digit alphanumeric code that taxpayers and tax preparers enter when prompted by their software product. The objective is to verify the information at the point of filing and prevent fraudsters from using fake Forms W-2 to create fraudulent refunds. Both the IRS and the states will receive several new data elements from individual returns that will help improve authentication of the taxpayer and identify possible identity theft scams.

IRS initiatives to prevent identity theft

Making progress against individual identity theft returns

Decreased incidences of reported and confirmed individual identity theft returns

Reported identity thefts (IRS)

2016

376,000

46%
from 2015

2017 (Jan.–Aug.)

189,000

40%
from 2016
(Jan.–Aug.)

Institutions taking action

IRS

2016

stopped 883,000
confirmed identity theft returns

37%
from 2015

2017 (Jan.–Aug.)

stopped 443,000
confirmed identity theft returns

30%
from 2016
(Jan.–Aug.)

Financial institutions

2016

stopped 124,000
suspect refunds

2017 (Jan.–Aug.)

stopped 127,000
suspect refunds to-date

Identity theft at the entity level

Identity theft at the entity level

The IRS has expanded its efforts to better protect pass-through and corporate entity filers and identify suspected identity theft returns. This includes C and S corporations, partnerships, estates, and trusts. For example, if a corporation or pass-through entity files Form 4466, Corporation Application for Quick Refund of Overpayment of Estimated Tax, the IRS will ask for confirmation of the filing before issuing the refund. It is also common for entity taxpayers to receive a notice confirming the responsible party for the corporation. If an estate or trust receives such a notice, it is to confirm the trustee as a responsible party.

Common business scams

Identity theft perpetrators often attempt to steal employee Forms W-2 or business employer identification numbers (EINs) to create fake Forms W-2 or 1099s. This data is then used to file fraudulent individual return filings seeking refunds. Information on reporting such scams is available in the IRS publication Form W-2/SSN Data Theft: Information for Businesses and Payroll Service Providers. The perpetrators may also use Schedule K-1 data to file fraudulent individual returns on behalf of shareholders, partners, or beneficiaries. Additionally, there has been an increase in fraudulent trust and estate return filings, including both on behalf of existing entities and those established using stolen individual taxpayer information. All entities should be certain to protect their computers and data to guard against identity theft and refund fraud.

IRS initiatives to prevent entity identity theft	
Person signing the return	• The name and SSN of the company executive authorized to sign the corporate tax return. • Is this person authorized to sign the return?
Payment history	Were estimated tax payments made? If so: • When? • How? • How much?
Parent company information	Is there a parent company? • Name, EIN, address of parent company.
Filing history	Has the business filed: • Form 940? • Form 941? • Other business-related tax forms?

Additional information may be requested based on deductions claimed.

Warning signs for entities

As with fraudulent individual returns, there are certain warning signs that may indicate entity identity theft. Business, partnerships, and estate and trust filers should be alert to potential identity theft and contact the IRS if they experience any of these issues:

- An extension to file request is rejected because a return with the EIN or SSN is already on file
- An e-filed return is rejected because a duplicate EIN/SSN is already on file with the IRS
- Failure to receive expected and routine correspondence from the IRS, which may indicate a criminal has changed the address

Look again at how you safeguard your personal financial information

While the IRS has made solid strides toward reducing the number of individual and entity identity theft instances, you still need to remain vigilant about your personally identifiable information. In 2018, you should also be prepared for the IRS to be inquiring about new information to assist it in verifying your true identity. Your tax adviser can help you take another look at how to guard yourself from identity theft or respond if it occurs.

Resources

Private wealth	Deloitte Private Wealth Private Wealth brochure
Tax reform	Tax Reform insights Tax News & Views: Capitol Hill briefing
Individual income tax planning	Private wealth tax controversies: Deep experience navigating interactions with taxing authorities
Wealth transfer planning	Wealth planning: Securing your legacy US estate and gift taxation of resident aliens and nonresident aliens
Philanthropy	Private foundations: Establishing a vehicle for your charitable vision
Identity theft	IRS Identity Protection Specialized Unit: +1 800 908 4490 IRS.gov, Identity Protection: Prevention, Detection and Victim Assistance IRS.gov, Taxpayer Guide to Identity Theft IRS.gov, Identity Theft Guide for Business, Partnerships and Estate and Trusts Helpful resources: Publications, articles, YouTube videos and other identity theft related outreach IRS.gov, Tax Scams / Consumer Alerts IRS.gov, IRS Publication 5027, Identity Theft Information for Taxpayers Federal Trade Commission: Consumer Information, Identity Theft

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