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STRATEGIC ADVISORY

2017 YEAR-END PLANNING LETTER

Since last year's U.S. presidential election, we have grappled with the lack of clarity regarding the details of new tax legislation. The outcome of the tax reform debate is likely to impact how we advise clients on tax planning, estate planning and a host of other topics. The dialogue in Washington is progressing, but we still do not know what tax law will look like going forward.

There are a variety of reasons why progress on tax reform has lacked urgency until recently. Our colleague Buck Chapoton discussed several of these reasons earlier this year in an extended Q&A ("Tax Reform: Then and Now"). As Assistant Secretary of the Treasury for Tax Policy during President Reagan's first term, Buck was instrumental in the Reagan administration's tax reform efforts. He notes that in the 1980s, there was a dire need to jump-start a moribund economy, and the administration was able to mobilize bipartisan cooperation to enact reform. Those conditions do not exist today.

As we write this letter, Congress and the White House are working to develop and finalize a tax plan by the end of this calendar year. Recent draft proposals have offered additional clarity on everything from deductibility of state and local taxes, to treatment of pass-through entities, to the potential phasing out of the federal estate tax. But these proposals are still being debated.

The purpose of this letter is not, however, to examine politics or to forecast ongoing legislative debates. Each year, we send a year-end planning letter to clients to help guide an annual planning review where we reconsider your circumstances and any relevant changes in the external planning environment. Our goal is always to identify appropriate steps that either advance your existing plans or modify those plans in an effort to ensure that they remain on track to deliver the long-term outcomes you seek.

We are closing 2017 with nearly the same stance as last year. With a highly uncertain tax environment, we see few drivers pushing us to recommend major adjustments to our clients' long-term plans with regard to tax, family wealth transfer or philanthropic planning. We are analyzing the potential impact of the current tax proposals; while it is hard to predict any final tax proposal outcome, there is a chance for estate and gift tax relief, so we are advising clients to avoid steps that might incur gift tax and are encouraging the use of exemptions and gifting strategies that have little or no gift tax consequences.

SPOTLIGHTS FOR PRUDENT PLANNING IN 2017

There have been very few changes to tax law in 2017, given that Congress has been focused on the longer-term tax reform effort. For gifting, the annual exclusion gift limit is still $14,000 per individual. The estate tax exemption rose slightly to $5.49 million per individual ($10.98 million per couple). In 2018, the annual exclusion is set to rise to $15,000 per individual and the estate tax exemption to $5.6 million ($11.2 million per couple). Of course, this is according to current law; these figures are subject to change depending on what happens with current tax reform efforts.

Given the lack of pressing policy deadlines, we can focus on the basic steps needed to implement our clients' long-term plans. With those parameters in mind, we wanted to highlight a few concepts.

1. Prudent estimated tax planning can help you prepare for year-end strategies, avoid penalties and plan for needed liquidity, especially in a period with few investment losses. Managing tax liabilities is always important—especially so in a rising market and a robust environment for business transactions. Younger clients may be new to the requirement to pay estimated taxes, and many are actively building taxable, income-generating portfolios where traditional tax withholding does not exist. This should be a particular area of focus, as the impact of traditional elements of our tax calculation may be changing (rates, deductions

and credits). This sort of planning involves both art and science; when done well, it helps ensure protection against penalties for income tax liabilities without overallocating for that protection.

In order to be penalty-proof, taxpayers need to pay in either 110% of prior-year liabilities, or 90% of current-year liabilities. Since current-year liabilities are largely unknown until the end of a given year (or perhaps well into the following year), most clients focus on the prior-year method of calculation to be in a "safe harbor" position and therefore penalty-proof. There are times that a more strategic approach should be employed, such as the year following a material change to tax liabilities (a big transaction or bonus, for example), which complicates this question and creates the risk of meaningful overpayment. These are some of the moments where we partner with our clients' tax professionals to manage these liabilities more precisely.

We can help coordinate with clients and their tax advisors to help reduce the chances of penalties. Being thoughtful on this issue can be an important factor in any clients' overall liquidity planning for the year; this is especially true in a year like 2017, when notable tax law changes are likely and clients may have fewer liabilities to offset gains given the market's strong performance.

2. With the rise in asset valuation in recent years, we encourage clients to review asset protection plans. Nearly all investors seek to protect and preserve their wealth. Specifically, many investors can benefit from strategies that shield their assets from both known and unknown risks. Many of our clients use a combination of trusts and other structures, alongside insurance of various types, to protect their assets. It is important to review and adjust these protections over time to account for changes in asset values.

For example, we are encouraging many of our clients to review their excess liability insurance. Most of us have coverage for specific risks associated with our homes and other property; while we generally believe that all clients can benefit from an excess liability policy, those who own rental properties, second homes or boats may need greater coverage. There are so many factors to consider beyond the already complicated consideration of income and

ANNUAL PLANNING CHECKLIST

INCOME TAX	
☐	Review opportunities for tax loss harvesting to offset realized gains.
☐	Review opportunities to accelerate/decelerate income and capital gains, based on current tax environment and future tax exceptions.
☐	Review charitable gifts and assets to maximize deductions.
☐	Review estimated tax plans for the coming year and determine if payments should be based on prior-year liabilities ("safe harbor").
☐	Ensure optimal timing of state tax payments.
☐	Maximize retirement plan contributions.
☐	Consider IRA conversion(s).
TRANSFER TAX	
☐	Review use of annual exclusion gifts.
☐	Review use of gift exclusion for payments of tuition and medical expenses.
☐	Review lifetime gift and GST gifting opportunities.
☐	Evaluate options for advanced planning vehicles.
☐	Review intrafamily loans and opportunities to leverage a low interest rate environment.
☐	Consider use of short-term Grantor Retained Annuity Trusts (GRATs) for concentrated positions.
PHILANTHROPY	
☐	Consider use of long-term appreciated securities for charitable gifting.
☐	For IRA owners over 70½, consider use of up to $100,000 for direct gifts to charity (this can fulfill annual distribution requirements).
☐	Consider various structures—donor-advised funds, private foundations, lead and remainder trusts, etc.—for achieving philanthropic goals.
☐	For private foundations, consider transfers of appreciated securities (this can satisfy distribution requirements and avoid excise tax).
INVESTMENTS	
☐	Optimize asset location to achieve best long-term balance of liquidity and tax efficiency.
☐	Review outstanding mortgages and other loans to identify opportunities to improve structure.
☐	Complete annual review of all trusts and trust documents.
PROTECTION	
☐	Review property and casualty insurance in light of changes that may have taken place with your tangible assets.
☐	Review beneficiaries of retirement plans and life insurance policies.
☐	Review health care proxies, living wills, powers of attorney and other important legal documents.
EDUCATION	
☐	Review opportunities to fund IRAs for young adults with earned income and/or establish matching programs to raise level of engagement.

assets. Is there a new teenage driver in the family? Is there dangerous terrain on newly acquired real estate? Careful consideration of a wide range of factors can lead to a better assessment of the right level of coverage. Adding coverage can also be economical—often, our clients are able to increase coverage from $1 million to $5 million without a substantial increase in cost.

3. Parents and grandparents of teenagers can help to fund retirement accounts for long-term growth and education. Our clients frequently ask us how they can help the rising generation in their families learn about investment fundamentals and sound financial practices. One fantastic option is to match a younger investor's income with a contribution to an individual retirement account (IRA). If an investor earns enough income, his or her parent or grandparent can contribute up to the normal IRA limit for them; if the investor's income level is less than $118,000, the parent or grandparent can contribute to a Roth IRA. Early funding of an IRA can pay off immensely over the long term, due to the power of compounding, and the tangible benefit for the younger investor is enhanced by a clear, practical education about the wisdom of long-term saving and investment planning.

4. Continue annual gifting plans through annual exclusions, tuitions or medical expenses. If there is more gifting capacity after these gifts, consider advanced strategies for providing gifts that work well in low interest rate environments. The gift tax exclusion for 2017 is $14,000 per gift recipient and rises to $15,000 in 2018. The annual exclusion gift is a "use it or lose it" opportunity—it does not carry over from one year to the next. Providing gifts on a tax-free basis is an ideal way to reduce, and possibly eliminate, larger gift and estate taxes in the future.

Beyond the annual exclusion, clients should consider ways to leverage currently low interest rates when providing gifts to family.

Loans/Sales: Family members can lend to one another at interest rates set by the IRS (1.52% for short-term loans and 2.64% for long-term loans as of December 2017); such loans let clients shift investable capital to a younger generation without incurring a gift tax. Borrowers will receive the spread between the interest owed and whatever return they can earn on the portion of the loan that is invested. This strategy can facilitate the sale of assets to a family member who can fund the purchase by taking a loan.

Grantor Retained Annuity Trusts (GRATs): A GRAT is established for a specific term of years, with its creator (the "grantor") contributing assets in trust. During the term of the trust, the grantor retains the right to receive the original value of the assets used to fund the trust plus an IRS-determined rate of return, currently 2.6%. When the trust terminates, remaining assets that appreciated more than 2.6% are distributed to beneficiaries. An example: A grantor established a GRAT in March 2017 for $1 million and invested in high-growth assets. By September 2017, the assets appreciated $100,000 beyond the original value plus required annuity payments. The grantor swapped the initial holdings for less volatile assets to stabilize the portfolio and secure the $100,000 for eventual transfer to beneficiaries free of gift tax.

Charitable Lead Annuity Trusts (CLATs): A CLAT pays a fixed amount each year to charity, with the remainder at the end of the trust's term going to noncharitable beneficiaries. Given that interest rates still sit at historically low levels, clients with philanthropic goals seeking estate reduction may wish to consider creating a CLAT. As with GRATs, the annual payout requirement is dictated by IRS guidance, so when rates are low, payouts can also be lower, which leaves more assets in the trust for later distribution to the noncharitable beneficiaries. These transactions are designed not to generate gift or estate taxes.

There are many other "blocking and tackling" steps to consider. We can look at your outstanding mortgages and other loans to ensure you are benefiting from the most advantageous available terms. We can dedicate time to reviewing any and all of your existing trusts and trust documents to verify that they are fully aligned with your evolving goals. And we can review your other "framework" documents—wills, health care proxies, living wills, powers of attorney—to confirm that your intentions for your legacy will be carried out as you wish. All of these steps are just as important as tax planning for many of our clients, and we hope to use this planning cycle to revisit these topics with you and look for opportunities to enhance existing plans or at least reconfirm what you have in place currently.

CONCLUSION

We have covered a variety of planning steps in this letter; some are universally applicable, while others may only apply to some clients. A variety of other matters are covered in the broad checklist we provide each year as a starting guide for year-end conversations *(see page 2)*.

The effectiveness of some of these steps may be reduced or eliminated if tax policy changes before you act, so as always, we recommend a thorough examination of the steps available to you and prompt action when warranted. In contrast, we are counseling caution on a variety of potential actions until the fog of the current tax reform debate lifts and we know more about what tax law will look like going forward.

Most importantly, we want to emphasize the value of regular planning reviews as more than a backstop against calendar-year or policy-driven deadlines. Long-term planning works best as an incremental process, in which we periodically revisit our collective assumptions about your goals and circumstances, and continually seek out additive steps that can help you progress toward your long-term objectives. During some years, we face hard external policy deadlines that dictate planning steps; this year, we do not, so we have an opportunity for greater reflection and review of your ultimate aims. We greatly look forward to these conversations with you and your other advisors.