COCHRAN ‡ ALLAN

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To our Clients and Friends:

We hope this letter finds you and your loved ones happy and healthy! We at Cochran Allan remain grateful to have an amazing team and a wonderful group of clients. We invite you to visit our new website to learn more about the firm and some of our newest members. As always, we are so thankful for your trust in us and look forward to our continued work together.

As we all know, 2017 was an eventful and often tumultuous year, leaving some uncertainty of what lies ahead. Congress made significant changes to the tax laws in December with the Tax Cuts and Jobs Act, and we write, in part, to explain some of those changes. We encourage you to speak with us, or with your financial advisor or accountant, to understand how the changes impact you. Additionally, as we do each year, we enclose information about recent legal developments that may be important to your planning.

We look forward to seeing you soon!

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ESTATE TAX UPDATES

- **Federal Estate, Gift and GST Taxes.** In December 2017, Congress doubled the estate, gift and generation-skipping transfer ("GST") tax exemptions to $10 million per person, adjusted for inflation. As of January 1, 2018, the exemptions are $11.2 million per person and $22.4 million for married couples. Transfers in excess of this amount, during life or upon death, will be taxed at a 40% rate. Unless Congress acts to make the increases permanent, these exemption amounts are set to expire at the end of 2025, returning on January 1, 2026 to $5 million per person (adjusted for inflation from 2012).

- **Federal Gift Tax Annual Exclusion.** For gifts made in 2018, the federal gift tax annual exclusion amount is increased to $15,000 per donor (or $30,000 for married couples who elect to split gifts).

- **Virginia Estate Tax.** Virginia continues to have no estate tax.

- **District of Columbia Estate Tax.** The D.C. estate tax exemption amount is "coupled" with the federal amount. Therefore, the D.C. estate tax exemption increased to $11,200,000, effective as of January 1, 2018. However, D.C. is considering "decoupling", so the D.C. estate tax exemption amount could be reduced, perhaps even retroactive to January 1st.

- **Maryland Estate Tax.** As of January 1, 2018, the Maryland estate tax exemption amount is $4 million. In 2019, this amount may increase to match the federal exemption amount, and we will inform you when Maryland confirms its exemption amounts for future years. Maryland also imposes a 10% inheritance tax, independent of its estate tax, on property passing at death to beneficiaries other than the decedent's spouse or domestic partner, parents, siblings, lineal descendants or their spouses.

PLANNING FOR INCREASED EXEMPTION & PORTABILITY

This is an ideal time for clients to revisit their estate plans. Between the increased tax exemptions and portability, traditional credit shelter or bypass trusts often are not needed, and estate planning for many of our clients should be streamlined. High net worth clients who still have taxable estates, even after the increased tax exemptions, should consider additional transfers to utilize their remaining gift and GST tax exemptions. ***We continue to encourage clients who have not reviewed their estate planning documents since 2012 to contact us.***

Portability, which became a permanent tax benefit in 2012, allows a surviving spouse to add a deceased spouse's unused federal estate tax exemption to his or her own exemption amount. In order for a surviving spouse to take advantage of portability, the executor of the deceased spouse's estate generally must elect portability by timely filing a federal estate tax return, even if filing an estate tax return is not otherwise required.

Clients also should review their existing irrevocable trusts to ensure their goals are met. State trust laws have matured significantly over the past five years, and many irrevocable trusts now can be modified without court involvement. Through non-judicial settlement agreements (NJSAs), the trustees and beneficiaries of a trust (with the trust creator, if living) can modify the trust's provisions. A procedure known as "decanting" also is an excellent tool for improving trusts. Decanting allows a trustee to transfer trust property from one irrevocable trust to a second, improved irrevocable trust.

We also are increasingly focusing on income tax issues surrounding irrevocable trusts. For older living clients who gifted property to an irrevocable trust, we should review the client's personal holdings and their trust's holdings to consider substituting or "swapping" personal assets that have a high cost basis for trust assets that are of equal value but have a low cost basis. The benefit of these asset substitutions is that when the client passes away, his or her personal assets will receive a step-up in cost basis to fair market value, thereby eliminating capital gains when the assets are sold. Conversely, assets in the client's irrevocable trust will escape estate tax, but will not receive the basis step-up.

Lastly, clients who are the trustees or beneficiaries of irrevocable trusts should consult us or their accountants to consider state income tax issues. In some cases, state income taxes can be minimized or avoided by moving a trust's situs or principal place of administration from a state with a high income tax, such as Maryland or Virginia, to a state with a low or no income tax.

MISCELLANEOUS PROVISIONS OF THE TAX CUTS AND JOBS ACT

The Tax Cuts and Jobs Act (the Act), which took effect on January 1, 2018, brought comprehensive changes to the Internal Revenue Code. You should consult your accountant regarding how these changes impact you. In addition to the increased estate, gift and GST exemption amounts, the Act included certain important changes that may be of interest.

Charitable Contribution Deduction Limitations

Following the Act, cash contributions to public charities are tax deductible up to 60% of a taxpayer's adjusted gross income. This is an increase from the 2017 limit of 50%. The limit for other contributions remains unchanged. Generally, contributions of appreciated property to public charities are deductible up to 30% of AGI; cash contributions to private foundations are deductible up to 30% of AGI; and contributions of appreciated property to private foundations are deductible up to 20% of AGI. Charitable contributions can be carried forward up to five years.

529 Plans May be Used for Elementary and Secondary Education

Following the Act, funds from 529 plans may now be used for elementary and secondary education, rather than just post-secondary education. Owners of 529 plans can distribute up to $10,000 per beneficiary, per year, for tuition at an elementary or secondary public, private or religious school. If a beneficiary has more than one 529 plan account, the amount distributed for the beneficiary's tuition from all accounts in a calendar year cannot exceed this $10,000 threshold.

Income Taxation of Alimony

Prior to the Act, alimony payments were tax-deductible for the paying spouse and taxable income to the receiving spouse. Starting in 2019, alimony payments will not be tax-deductible for the paying spouse or taxable income to the receiving spouse. However, this change applies only to payment made pursuant to separation of divorce agreements signed after December 31, 2018.

Income Taxation for Business Owners

Following the Act, there is now a flat 21% corporate tax rate for businesses set up as C corporations. Business income passing to an owner from a pass-through entity, such as a sole proprietorship, S corporation, LLC or partnership, remains taxed at the individual tax rate, reduced by a new deduction, in certain limited situations, of up to 20%. In addition to several other limitations, the deduction is limited for owners of certain 'specialized service businesses' if an owner's adjusted gross income exceeds $157,500 ($315,000 for married couples filing jointly), subject to adjustment for inflation, and the deduction cannot be taken at all if an owner's income from the business exceeds $267,500 ($415,000 for married couples filing jointly). Specialized service businesses include those in the fields of health, law, accounting, consulting, financial services, brokerage services, etc. The rules on the new deduction of up to 20% are very complex and each business owner's situation should be evaluated carefully.

POWERS OF ATTORNEY FOR FAMILY MEMBERS

Please make sure your adult family members have financial powers of attorney and advance medical directives (also known as health care powers of attorney) in place. Children age 18 or older should sign these forms to make sure their parents (or other chosen adults) can care for them in the event they are incapacitated. Most importantly, this includes naming their parents (or others) as agents who can receive medical information in the event of an accident. You also should make sure your parents have these documents in place so someone is properly designated to care for them as they age. While we tailor our clients' powers of attorney to their specific needs, basic forms are freely available and should be used for children and parents who do not have their own lawyers.

TRANSFERRING ASSETS TO REVOCABLE TRUSTS

As a reminder to our clients who we have not seen in some time (particularly our older clients), please review your holdings to make sure your assets are properly titled and your beneficiary designations for assets such as life insurance and retirement accounts are correct. Our general recommendations are as follows:

- Investment accounts should be titled to your revocable trusts
- Real estate should be titled to your revocable trusts (or LLCs)
- Holdings in business entities (corporations, LLCs and partnerships) should be assigned to your revocable trusts
- Traditional stocks and bonds should be titled to your revocable trusts
- Checking or operating accounts should be (i) titled to your revocable trusts, (ii) jointly held, or (iii) payable on death to your trusts or heirs
- Retirement accounts should have updated beneficiary designations and should not be payable to your estate
- Life insurance policies also should have updated beneficiary designations and should not be payable to your estate

With respect to rental real estate, we encourage our clients to title their rental properties in the name of a limited liability company (LLC), which, in turn, should be owned by a revocable trust in order to avoid probate. LLCs often provide significant benefits, such as liability protection against third party claims (from tenants or otherwise) and privacy, and also can streamline property management. It is relatively simple in most cases to form an LLC and transfer a rental property to the entity, but there are several issues to consider before proceeding. For example, it is important to confirm whether a conveyance of property will trigger any transfer or recordation taxes and, if the property is subject to a mortgage, what fees or guarantees the lender may require for consenting to the conveyance.

Lastly, married couples should ensure that their joint assets, which most commonly include personal use real estate and investment accounts, are titled as "tenants by the entirety", which provides the most creditor protection available to property held jointly. This can be achieved in Maryland and Virginia even when assets are held in spouses' revocable trusts.

Please do not hesitate to contact us to schedule a review of your assets and confirm they are titled properly to avoid probate and maximize asset protection.

CHANGES TO VIRGINIA'S ELECTIVE SHARE LAW

Almost every state seeks to prevent spouses from disinheriting each other without a pre-marital or post-marital agreement. Generally, a surviving spouse may elect to inherit a portion of his or her deceased spouse's estate, in lieu of what the deceased spouse specifically left the surviving spouse. This is called the surviving spouse's "elective share". In most states, the elective share is between 1/3 and 1/2 of the deceased spouse's estate, but the states are not uniform in their approach, and, in many states, it is possible to circumvent the elective share law through sophisticated planning.

Virginia adopted new elective share laws in 2017. Under Virginia's new laws, a surviving spouse may elect to claim up to 50% of the value of the marital-property portion of the so-called augmented estate. The specific percentage a surviving spouse may elect increases with the duration of the marriage. For example, if a couple has been married for less than one year, the elective share is 1.5% of the augmented estate. If a couple has been married between 10 and 11 years, the elective share is 30%, and, if a couple has been married for 15 years or more, the elective share is 50%.

The marital-property portion of the so-called augmented estate consists of virtually all of the spouses' property, including:

- The decedent's "net probate estate", meaning the probate estate reduced by certain expenses, allowances and claims;
- The decedent's non-probate transfers to others, such as transfers on death from bank accounts or through a revocable trust;
- The decedent's non-probate transfers to the surviving spouse; and
- The surviving spouse's property.

However, the spouses' separate, non-marital property, such as inherited assets that have never been comingled, is not included.

A surviving spouse who wishes to claim his or her elective share must initiate proceedings to do so within six months of the date the deceased spouse's Will is admitted to probate.