SHERMAN WELLS
SYLVESTER & STAMELMAN LLP

TAX AND TRUSTS & ESTATES UPDATE

November 2019

2020 Inflation Adjustments for Tax Items

With the new year will come new inflation adjustments for several tax-related items. Some of the more significant changes that will take effect on January 1, 2020 (and noteworthy items that have remained unchanged), are listed below.

ESTATE AND GIFT ADJUSTMENTS

Estate, Gift and Generation-Skipping Transfer (GST) Tax Exemption. The estates of decedents dying in 2020, as well as gifts made in 2020 above the annual exclusion, will have an aggregate exemption of $11,580,000 (up from $11.4 million in 2019). The GST exemption also increases to $11,580,000 in 2020 (up from $11.4 million in 2019).

Annual Gift Tax Exclusion. The annual gift tax exclusion for 2020 remains $15,000. The annual gift tax exclusion for gifts to a spouse who is not a United States citizen will be $157,000 (up from $155,000).

PERSONAL INCOME TAX ADJUSTMENTS

Application of the Highest Tax Rate. The tax rate of 37% affects single filers whose income exceeds $518,400 (up from $510,300) and $622,050 for married joint filers (up from $612,350).

Standard and Itemized Deductions. The 2020 standard deduction rises to $12,400 for single filers and $24,800 for married couples filing jointly (up from $12,200 and $24,400, respectively).

Beginning in 2018, and continuing since, itemized deductions are no longer subject to an overall limitation with respect to adjusted gross income exceeding specified thresholds.

Personal and Dependent Exemption. Taxpayers are no longer allowed personal or dependent exemptions for tax years beginning January 1, 2018 through 2025. Prior to 2018, taxpayers had been allowed a personal exemption, as well as exemptions for dependents, subject to certain phase outs at higher income levels.

Alternative Minimum Tax. The Alternative Minimum Tax exemption amount for taxable year 2020 is $72,900 for single filers (up from $71,700) and $113,400 for joint filers (up from $111,700).

In This Issue

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RETIREMENT SAVING ADJUSTMENTS

Retirement Plan Contribution Limits. The 2020 contribution limit for 401(k), 403(b) and 457 plans is $19,500 in 2020 (up from $19,000 in 2019), and the additional catch-up contribution limit for these plans for taxpayers who are age 50 or older has increased to $6,500 (up from $6,000 in 2019). The maximum contribution to IRAs is $6,000 (same as for 2019), with the additional catch-up contribution limit for taxpayers who are age 50 or older remaining at $1,000.

Deduction for Traditional IRA Contributions. The deduction for a traditional IRA for single people and heads of household covered by a workplace retirement plan will phase out at adjusted gross income between $65,000 and 75,000 (up from between $64,000 and $74,000). For married couples filing jointly, the income phase-out will be between $104,000 and 124,000 when the IRA contributor is covered by a workplace retirement plan (up from between $103,000 and $123,000), and between $196,000 and 206,000 (up from between $193,000 and $203,000) when the IRA contributor is not covered at work but is married to someone who is.

Maximum Roth IRA Contributions. For Roth IRAs, the income phase-out range is between $196,000 and $206,000 for married couples filing jointly (up from $193,000 and $203,000). For singles and heads of household, the income phase-out range is $124,000 to $139,000 (up from $122,000 to $137,000). For a married individual filing a separate return who is covered by a workplace retirement plan, the income phase-out range remains $0 to $10,000.

If You Want to Make Gifts to Charities or Others in 2019, Be Sure Those Gifts Are "Completed" this Year for Tax Purposes

As the year end approaches, many of you may want to make charitable gifts that can be deducted this year, or gifts to family or friends to use the 2019 annual gift-giving exclusion ($15,000 per recipient).

If you're a "last minute" gift-giver, how can you ensure that your gift will conclusively be "made" in 2019?

In all events, you must unconditionally deliver the gift to the recipient (or an agent of the recipient) in 2019.

- A charge to a credit or debit card in favor of the recipient in 2019 is a completed gift.
- Delivery of an endorsed stock certificate to the recipient or an agent of the recipient in 2019 is a completed gift. Delivery of an endorsed stock certificate to anyone else (e.g., your stockbroker, or the corporation's transfer agent) is not good enough, unless the transfer is actually recorded on the corporate books in 2019.
- A check mailed to a charity in 2019 is good enough. But if you are making a gift to an individual, the check should be paid, certified or accepted by the bank for payment, or negotiated to a third party for value before the end of 2019. The IRS may (but don't rely on this when you make your 2019 gifts) view the gifts as consummated in 2019 if the check was unconditionally delivered in 2019 (and intended to be a gift), presented at the bank for payment within a reasonable period of time after delivery, and honored while the donor was alive (IRS Revenue Ruling 96-56).

Remember that just dating a check in 2019 will not in and of itself be enough under any circumstances.

If you are considering gifts with any complications (e.g., through trusts, etc.), you need to get started immediately if you want to consummate those gifts by year end.

Finally, given the higher standard deduction, you should consult your tax advisor before you make your year-end charitable gifts. It may make sense to accelerate 2020 gifts in 2019, or to defer 2019 gifts into 2020, depending upon which year is expected to have larger itemized deductions for you.

Thinking of Converting your S Corporation to a C Corporation? Avoid this Trap for the Unwary.

With the reduction in the corporate tax rate under 2017 Tax Reform, many small business owners are exploring the possibility of converting their S Corporations to C Corporation status. Among the many issues to be considered is the distribution of the S Corporation's previously taxed but undistributed earnings.

S Corporation shareholders are taxed on their earnings in the year earned, regardless of whether such earnings have been distributed to the shareholders at that time. The S Corporation records its taxed but undistributed earnings in a separate "accumulated adjustments account" (AAA).

After an S Corporation converts to C Corporation status, the newly converted C Corporation generally may distribute the balance of the S Corporation's previously taxed earnings in the AAA to its shareholders tax-free during the post-termination transition period (PTTP). The PTTP is the period beginning the day after termination of S Corporation status and ending one-year after such termination date or the due date for filing the final S Corporation return (including extensions), whichever is later.

Generally, previously taxed earnings distributed by the C Corporation after the termination of the PTTP risk being taxed a second time as dividends to the shareholder, to the extent such distributions would otherwise be treated as dividends. The IRS has taken the position, recently accepted by the District Court of Oregon, that dividend treatment cannot be avoided by reverting to S Corporation status after the termination of the PTTP and making the distribution from the former AAA after such reversion. Accordingly, prior to converting to C Corporation status, shareholders of an S Corporation should assess whether the corporation has sufficient cash to distribute the balance of its AAA during the PTTP and ensure that the appropriate distributions are made prior to the expiration of the PTTP.

The Nonprofit Forum

This is another in a series of articles on nonprofit organizations that we feature in our regular Updates. We have found this area to be one of ever-increasing interest to our clients and colleagues, and we hope you will find these articles helpful and insightful.

Is it Time to Convert Your Private Foundation to a Donor-Advised Fund?

If you have created or are otherwise involved in the management of a private foundation, each year you must make decisions about how to meet your 5% minimum distribution requirement, as well as deal with the preparation and filing of an annual Form 990PF with the IRS and the payment of tax on your foundation's investment income. For large private foundations, these are undoubtedly aggravations that are justified given the magnitude of the foundation assets and the internal infrastructure that is likely in place to manage the foundation. But with smaller foundations, it may be time to consider housing the foundation's assets in an alternative vehicle that may just as adequately meet the philanthropic objectives of the foundation: the donor-advised fund.

Donor-advised funds are operated by community foundations and other entities that are, themselves, recognized for tax purposes as public charities. That means that a private foundation that wants to cease operation can appropriately distribute all of its assets to a donor-advised fund.

The recipient donor-advised fund can generally take on a name similar to the terminating foundation. The individuals who control the terminating foundation can specify the individuals who will periodically recommend how the fund is to be distributed. A mechanism for designating additional recommenders and successor recommenders can also be put into place in many donor-advised funds, so that participation in the disposition of the fund can extend through generations in a manner similar to the evolution of a family foundation through successive generations. The terminating foundation may even be able to provide input regarding the future investment of the assets of the donor-advised fund. And the donor-advised fund can, of course, continue to accept donations from the original foundation founders and their families (as well as anyone else who might want to contribute).

Our clients who have terminated private foundations into donor-advised funds are generally quite pleased with the result. They like the fact that they can participate in the disposition of the fund in a manner similar to a private foundation, but without the cost or administrative aggravation involved in managing a private foundation. And it is very simple to terminate a private foundation into a donor-advised fund – it essentially involves no more than transferring the foundation's assets, filing a final Form 990-PF with the IRS and notifying the state of the foundation's termination (state requirements will vary based upon the laws of the state where the foundation was created).

If your foundation is small and/or you are tired of addressing the administrative entanglements of operating a private foundation, you should consider the donor-advised fund as an alternative.

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