Estate planning for Washington residents

By Sandy J. Cairns

The death of a loved one can be one of life's most difficult events. People generally agree that a smooth transition of assets after a death is desirable. And yet many people fail to plan and turn what could be a smooth transition into a painful process. Failure to plan can not only increase the cost of administering an estate, but also lead to unintended consequences such as paying more tax.

The new tax laws enacted at the end of 2017 doubled the amount one could gift during life or leave to heirs upon death. That amount was increased from $5 million to $10 million per person. After adjusting for inflation, that amount rose to $11.4 million per person in 2019. Coupled with "portability" - which enables a married couple to effectively double this amount - a married couple can now give away $22.8 million during life or upon their deaths without facing a federal gift or estate tax obligation.

This raises the question of whether creating tax-planning trusts have become a thing of the past. Not in Washington state.

Washington state still has its own estate tax, which this year impacts estates over $2,193,000. Because the revenue from the Washington estate tax is earmarked for higher education, it is not likely to be repealed any time soon.

Many married couples mistakenly believe that they can double the Washington exemption like they can with the federal exemption. This is not true without tax planning. If all property were to pass to the surviving spouse outright, when that surviving spouse dies later, the surviving spouse only has his or her exemption amount. There is no "portability" of the Washington exemption amount like there is at the federal level. This can take many people by surprise.

The bottom line is that if the total value of a Washington resident's estate exceeds $2,193,000 - including real estate, life insurance proceeds, retirement, bank and investment accounts – then they should consider tax planning to address the Washington estate tax. Income tax considerations should also be addressed.

It is possible to structure an estate plan to include assets in the federal estate of a surviving spouse and to receive a basis adjustment while keeping those same assets out of a surviving spouse's estate for Washington purposes. Why is this important? Because it can save capital gains tax as well as Washington estate tax.

An additional planning technique is to give money away during one's lifetime. Although Washington state has an estate tax, it does not have a gift tax. Consider whether your Durable Power of Attorney for financial decisions includes a clause that would permit gifting and how much. A new law passed in 2016 limits gifts to the annual exemption amount ($15,000 this year) unless otherwise specified. While in the past gifts were often limited to the annual exemption amount, now that people can give away up to $11.4 million during their lifetime, they need not necessarily feel constrained by the $15,000 amount. Although gift tax returns must be filed for

gifts above that amount, it only reduces what one has left to give and with the current $11.4 million gift and estate tax exemption amount, there is room to spare.

Although gifting assets during life can be an effective way to reduce one's taxable estate, it's important to determine which assets to give because of the impact on basis and capital gains tax. For example, if stock bought for $10 a share is given away when it is worth $110, the receiver would have $100 of built in capital gains that is subject to capital gains tax when the stock is sold. However, if the stock is given away after the giver dies, there would be a step-up in basis to the date of death value, therefore avoiding the built-in capital gains. Engaging the assistance of a competent professional can help with the analysis of everyone's particular situation.

Tax planning can be done in either a will or a revocable living trust, which puts all of one's assets under a trust. Estates in Washington can go through probate efficiently without court supervision. This surprises people who have moved to Washington from other states where revocable living trusts are necessary to avoid a costly court-supervised probate administration. Nonetheless, there are circumstances that lend themselves to a revocable living trust plan. Difficult-to-transfer assets, out-of-state property, second marriages, and privacy concerns will weigh in favor of such a plan. But for those people without such concerns, a will-based plan can be more cost effective and simpler. Whether you chose a revocable living trust or a will, planning for both Washington estate tax and capital gains tax can be a complex analysis, unique to your particular situation.

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