Marble Harbor Investment Counsel, LLC
Excerpt from
Third Quarter, 2018 Letter

We are pleased to send an excerpt from our third quarter client letter that discusses our current thinking. We welcome your thoughts.

Sincerely,

Paul Davis, L.J. Harrington, Eric Robb and Daniel Rosenblatt

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Dear Client:

Recently, we attended a luncheon with noted economist Martin Feldstein. His message: "the current state of the U.S. economy is outstanding." This echoes the sentiments expressed in our last letter and is consistent with what we are continuing to hear from the managements of many of your companies. We don't know how long this will last, but for now the economy is in a sweet spot. Rather than plowing this field again, we thought we'd highlight a few emerging issues in tax and estate planning that we think will be of interest. Of course, before making any significant moves, you should discuss these strategies with your CPA and/or your estate attorney.

We want to alert you to some changes in tax law that may affect your charitable giving and estate planning. Previously, the standard deduction for federal income taxes was $6,350 for singles or married couples filing separately and $12,700 for married couples filing jointly. Many people, especially in high-tax states, would itemize their deductions every year because they exceeded the standard deduction. The tax law changes implemented in 2018 increased the standard deduction to $12,000/$24,000 (single/married). Further, state and local tax deductibility is capped at $10,000. Today, with a higher standard deduction and a cap on state and local tax deductions, many individuals without a mortgage will conclude that it is no longer necessary to itemize their deductions. If this is the case, your charitable donations may not give you any additional tax benefit.

It is estimated that 90% of Americans will take a standard deduction this year. This will greatly reduce the incentive for charitable giving, since the government is no longer footing part of the bill. Charities all over the country are concerned about their receipts. We serve on the investment committees of several charities, and donations are generally down from 2017 levels.

While charitable giving should first be driven by your philanthropic goals and affordability, after that, it makes sense to make your gifts as tax effective as possible. Fortunately, there are strategies to capture the tax savings for charitable donations that only change the timing of your gifts. The simplest approach is what accountants term "bunching" – making larger, less frequent gifts. You could, for example, make your donations and itemize them every other year, if your two years' worth of gifts exceeds the standard deduction threshold. During off years, you could skip donating and take the standard deduction. The downside of this strategy is that

charities require a steady stream of funds in order to operate, and your bunching could prove rather disruptive to their cash flows.

Donor Advised Funds address this potential problem. These are charitable giving accounts that allow you to make tax deductible donations today and give the money away over time. Donor Advised Funds provide a relatively simple, inexpensive method to, in essence, create a personal charitable foundation of virtually any size without the hassle, expense and legal complication of establishing an actual foundation. Previously giving mechanisms like this were prohibitively expensive and were reserved for the truly wealthy. Donor Advised Funds allow those who drive Fords to give like the Ford Foundation.

The strategy works like this: Say you plan to give away $5,000 a year for the next five years. If you take the standard deduction, you will not get a tax deduction on each year's gift. However, if you aggregate the donations for those 5 years and donate $25,000 to a Donor Advised Fund in the first year, your deductions will be high enough to allow you to itemize your taxes and receive the charitable deduction. Over the following five years, you will be able to direct the Fund to pay your charities of choice $5,000 per year, and thus can help the institutions better manage their cash flow and avoid lean years.

Endowing your Donor Advised Fund by using appreciated stock makes great sense. By doing so, you also avoid paying the hefty capital gains tax on stock sales, further boosting your tax savings. Donor Advised Funds, in certain circumstances, can also be funded with property, private company holdings and even Bitcoin.

Once the money or stock is in the Donor Advised Fund, it can continue to be invested and grow until you donate it. Over time, there is also flexibility as to how and when you make gifts to your designated charities. Assets from Donor Advised Funds can be given to any IRS-approved charity, such as your alma mater or your place of worship. If you want to give money to your local PTO, the Fund will work with you to get it added as an approved charity on its platform, if it is a 501(c)(3) and is not already on the "Approved" list. You may even be able to roll the entire balance to a different Donor Advised Fund or a private foundation in the future.

Another good strategy that allows you to take the standard deduction and still give to charity is to make the gift from your IRA. This method, called a Qualified Charitable Distribution, is available to those who are age 70½ or older. You can give your Required Minimum Distribution (RMD) directly to the charity, and in doing so, will not have to pay any income tax on it.

In the coming months, Charlotte, Laura and Mirely would be happy to help you open a Donor Advised Fund or make a Qualified Charitable Distribution if you are so inclined. They also would like to remind you to let us know as soon as you can about any gifts you would like to make, charitable or otherwise, to avoid the year-end rush, as custodians can restrict the ability to make stock gifts in the last few weeks of the year.

In the realm of estate planning, the revisions to the tax regulations are prompting CPAs across the country to reconsider some traditionally held assumptions. Historically, the rule of thumb has been to use various structures to push as much money as possible to future generations. The old estate

tax limit was $5.5 million for individuals and $11 million for married couples. Every dollar above this limit was taxed at 55% (plus state taxes). Estate attorneys counseled clients to put any money above $5.5mm in a trust to avoid the high estate tax rate. One downside to putting money into a trust was that you did not get the capital gains step-up that comes at death. Your heirs would be left to pay the tax (perhaps as much as 30%, depending on where you lived) on capital gains, but this was still a much better deal than the 55% estate tax.

The new tax law increases the estate tax limit to $11 million ($22 million for married couples), which means that far fewer individuals will have to pay **any** federal estate tax. If you have a trust and a taxable estate that would have exceeded the prior $5.5 million estate tax limit but is below the new $11 million limit, you may now want to consider taking assets back into your estate. Illogical as it may seem, this may be especially prudent if the assets have substantial embedded capital gains. By returning the assets to your estate, at your passing, the capital gains will reset to zero. If you do not, your heirs will pay capital gains taxes on the sale of the stock. With the new estate tax limits and proper planning, many people will pay **neither** estate taxes, nor any capital gains at their death. Death is still unavoidable, but estate taxes may be less so.

This is a counterintuitive estate planning strategy, but such are the opportunities presented by the new tax bill. As noted previously, we strongly encourage you to discuss these topics with your accountant and/or estate attorney. Something to always keep in mind during these discussions is that the new estate tax limits may not be permanent.

Antoine de Saint Exupéry sagely advised, "As for the future your task is not to foresee it but to enable it." Fulfilling your charitable goals and safeguarding the wellbeing of generations to come can be challenging, especially when the rules of the game are in flux. We want to help you face those challenges by not only looking after your investments, but also by partnering with you and your other advisors to ensure that you are optimally positioned to respond nimbly to a changing financial landscape.

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