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Tax Cuts and Jobs Act: What Estate Planners Need to Discuss With Their Clients

The largest tax reform in over three decades has now been signed into law. The Tax Cuts and Jobs Act (act) became law on Dec. 22, 2017, and will have wide-ranging implications for many industries. This article will address some of the possible estate planning possibilities.

By **Rebecca Sallen** | February 12, 2018

The largest tax reform in over three decades has now been signed into law. The Tax Cuts and Jobs Act (act) became law on Dec. 22, 2017, and will have wide-ranging implications for many industries. This article will address some of the possible estate planning possibilities.

Major elements of the act include an increase to the estate tax, the gift tax and the generation-skipping tax exemptions while preserving a step-up in basis at a taxpayer's death.

Background

The original U.S. estate tax was created in 1916 and imposed a tax on estates over $50,000. The exemption limit has risen over the years and in 2017, the exemption was $5.6 million for an individual or $11.2 million for a married couple under the portability provisions. The Tax Cuts and Jobs Act doubles the exemption to $11.2 million for individuals and $22.4 million for married couples. As in prior years, these exemption rates are indexed for inflation, but now using a chained consumer price index approach

The Tax Policy Center estimates that approximately 11,310 individuals dying in 2017 will be subject to the estate tax of which only 5,460 estates will owe tax after credits and deductions. Portability of a deceased spouse's unused exclusion remains available, so that spouses with a combined estate up to $22.4 million in value at the time of the survivor's death will not pay any federal estate tax with the proper planning and estate tax return elections. With this dramatic increase in the exemption and even fewer clients subject to paying federal estate tax, at face value, the act seems to nullify any reason for most Americans to plan their estate. Yet, the need for competent counsel and communication with clients remains strong; it may become necessary to draft new trusts and gifting arrangements as well as revisit existing estate plans.

Take Advantage of This Time

The act became law while polling with the lowest popularity of any tax cut in the last 30 years according to surveys by CNN, Quinnipiac and Morning Consult. Approximately only a third of Americans surveyed approved of the act. Law suits have already been filed calling the act illegal. Even if the act withstands the courts and public disapproval, changes to the estate exemption are set to expire in 2025. Absent clarification of the sunset provisions, at most, current nonexcluded estates only have eight years to maximize use of the higher exclusion.

For clients whose spouse died in 2017, their exemption can be transferred to the surviving spouse to obtain the $22.4 million exemption. For individuals who are likely to be subject to federal estate taxes that will revert to $5.6 million, as adjusted for inflation, the temporary exemption offers them a unique planning opportunity.

The act is expected to increase the annual exclusion for gifts to $15,000 per recipient. It should be noted that the annual gift exclusion has not been confirmed. As with all gifts, the transferred assets are removed from from the donor's estate. Even if your client is considering gifting for non-tax reasons, such as asset protection, the increased exemption amount may be enough to tip the scales in favor of a lifetime gift.

Individuals may make gifts take advantage of the increased exemption and a special tax break available for transfers to a Section 529 plan. The act allows a one-time contribution to 529 plans that's effectively treated as if it's made over five years for gift tax purposes. For example, if grandparents want to help pay for college, they can transfer up to $150,000 to a 529 plan to each grandchild. ($15,000 x 2 spouses=$30,000 x 5 years=$150,000) This entire transfer in 2018 will be exempt from gift tax.

Spousal Lifetime Access Trusts

Married couples who want to take advantage of the temporary elevated exclusion but are concerned about loss of control over their finances or that lifetime gifts would deplete their funds so that they can no longer support their current or expected lifestyle, should discuss with their attorney whether a spousal lifetime access trust (SLAT) could strengthen their estate plan.

A SLAT allows one spouse (donor spouse) to make aggregate gifts of up to $11.2 million free of gift taxes to a nonreciprocal, irrevocable trust that names the donor's spouse (beneficiary spouse) as a lifetime beneficiary of the trust. The beneficiary spouse or the couple's children may serve as the trustee if his or her discretion is limited by an ascertainable standard. The gift constitutes a completed gift to remove the asset from

the donor spouse's estate, but ensures that the donor spouse will still have access to trust assets through the beneficiary spouse as long as the couple remains married to each other.

Importantly, the SLAT may also give the beneficiary spouse a limited (but not a general) power of appointment to distribute assets among the couple's children after the death of a beneficiary spouse. Clients should evaluate whether to establish SLATs (or make transfers to existing SLATs) before the increased exemption amounts expire. As long as the gifts to the trust are below the increased exemption amount, a transfer to a SLAT may offer increased protection against future changes to tax laws with little downside risk.

The act remains silent as to whether large gifts made between 2018 and 2025 will be "clawed back" into the grantor's estate if the grantor dies after 2025 for purposes of determining a taxable estate. The IRS has yet to issue regulations that address this.

Power of Appointment Planning

Structuring appropriate powers of appointment have always been a valuable technique in estate planning. Powers of appointment give the flexibility necessary to alter asset disposition if there is a change in the beneficiaries' circumstance such as a future divorce, disparate income among siblings or addiction.

Now with the new act's elevated exclusion, practitioners should discuss using general power of appointments as a tool for basis reapportionment, as holding such power would cause inclusion of the property subject to the power in an individual's gross estate for tax purposes. The inclusion of those assets allows those assets to receive a step-up in basis. Clients concerned about capital gains may benefit from utilizing a power of appointment by giving an older, trusted relative a general power of appointment for basis step-up purposes. The step-up in basis will only relate to assets held by the trust and be valued at the death of the elderly relative. Before, this may not have been a suggested strategy as the relative's taxable estate may have exceeded the

exclusion after combining their estate with assets given by a power of appointment. The act's $11.2 million exclusion for an individual allows many more clients to take advantage of this strategy.

Revisit Old Plans

Even for estates that are not above the exclusion, the act provides incentive to revisit previously drafted estate plans. As taxable estates have moved from $600,000 in 1997 to $1 million in 2002 to today's current rate, prior plans were created with an emphasis on saving taxes. These existing estate plans may no longer operate as intended. This is especially true if there were multiple trusts established at death based on formula clauses involving the estate tax exemption amount. Trusts drafted with a typical formula clause for a married couple may have funded a credit shelter trust for children using the full federal exemption. Without revising these plans, the result would leave less than originally expected to the surviving spouse or even nothing at all.

Older trusts that focused on saving taxes tend to contain now unnecessary restrictions on the control that the survivor would have over trust assets. In addition, unrevised trusts may incur unnecessary capital gains at final distribution since the "step-up in basis" would not be available at the death of the surviving spouse. Prior plans that did not include necessary flexibility based on changing tax codes may serve the opposite purpose that they were intended as assets may be tied up in expensive estate administration.

Lastly, removing the specter of family members having to pay estate taxes allows clients to focus on nontax reasons for planning such as protecting and preserving assets. These nontax reasons are an opportunity for attorneys to differentiate themselves and offer value to their clients.

Conclusion

While this article points out several key consequences of and opportunities brought by the new law, it is important to note that tax law remains a moving target. A change in administration or control in Congress may lower the estate tax exemption to 2017 levels or even lower. Attorneys should discuss with all of their clients whether an existing estate plan is taking advantage of current changes as well as determining if the plan has the necessary flexibility.

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