LEGAL UPDATES

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Service

Private Wealth

Update Your Estate Plan: Tax Cuts and Jobs Act Provides Planning Opportunities

KEY POINTS

What Does the Tax Act Change?

The estate, gift and GST tax exemptions are doubled from $5 million to $10 million (adjusted for post-2011 inflation).

Taking into account post-2011 inflation adjustments, for a single person, the exemption will be $11.2 million. For married persons, the combined exemptions will be $22.4 million.

Are the Changes Permanent?

No. The changes apply only until December 31, 2025. Extension beyond that date will require future action.

What Did Not Change Under the Tax Act?

Several significant aspects of current law did not change, some of which have implications for ongoing estate planning:

The estate, gift and GST tax law is <u>not</u> repealed, as was proposed in the original House bill.

The tax rate for estate, gift and GST taxes remains at 40 percent.

The income tax basis adjustment (typically a step-up in basis for assets inherited at death) is unchanged.

The unlimited estate tax and gift tax marital and charitable deductions are unchanged.

Portability (the ability of a surviving spouse to use the unused estate and gift tax exemption of his or her predeceased spouse) remains unchanged.

What are the Planning Implications and Opportunities for Taxpayers?

For taxpayers with estates greater than the 2017 exemption levels:

The increased exemptions provide the opportunity for tax-free gifts that could place assets permanently outside the transfer tax system (even if the increased exemption levels do not extend beyond 2025 or are earlier reduced by action of a different Congress and President).

For taxpayers with estates less than the 2017 exemption levels:

Wills and trusts that include formula provisions tied to the applicable estate tax and GST tax exemptions should be reviewed (see discussion below).

Opportunities may exist for basis adjustment planning (see discussion below).

What are the Implications for Formula Clauses in Wills and Trusts?

Traditional estate planning has utilized formula clauses for the disposition of assets that take advantage of the federal estate tax marital or charitable deductions in combination with the available federal estate tax exemption. Sometimes formula provisions are also tied to the federal GST tax exemption.

Such formula provisions normally self-adjust to changes in tax laws. When tax law changes are substantial – such as those made in 2011, when the estate tax and GST tax exemptions were increased to $5 million, or those made under the Tax Act – the plan of disposition could be skewed by these formulas, thus affecting intended benefits for a surviving spouse, charitable beneficiaries, or children and grandchildren.

Taxpayers should review existing estate plans for the potential impact of the Tax Act on the formula provisions in their wills and trusts.

What are the Basis Adjustment Issues?

Generally, the provisions of the income tax laws provide for a basis adjustment for property inherited upon an individual's death if such inherited property was included in the deceased individual's taxable estate. In other words, assets that have appreciated in value will have their basis "stepped-up" to fair market value.

If assets are not included in the deceased individual's taxable estate – for example, they are acquired from an irrevocable trust – the recipients of the property may receive a "carryover" basis and not a stepped-up basis.

Traditional estate planning has used irrevocable trusts created at the death of a first spouse to exclude assets from the survivor's taxable estate to the extent possible. However, in light of the increased estate tax exemption from the Tax Act, excluding the assets from the survivor's taxable estate may not yield a tax benefit. As a result, it may be better to have assets included – rather than excluded – from an individual's taxable estate so as to obtain the benefit of a step-up in basis.

Customized provisions included in the terms of wills and trusts can be used to achieve the best overall tax result.

Is There Anything Else to Consider?

Some states have their own estate or inheritance tax laws, which may be affected by the Tax Act.

Planning for basis adjustment or modification of formula provisions could have implications for such state transfer tax laws.

What This Means to You

Like many other provisions in the Tax Act, the impact of the changes made to the estate, gift and GST taxes will depend on an individual's circumstances. For some individuals, the changes will provide considerable planning opportunities to shelter assets from transfer taxes. As with the substantial increase in exemptions made in 2011, estate plans should be examined to determine the effect of the changes where wills or trusts contain formula provisions. With the increased estate tax exemption, more taxpayers may have opportunities to take advantage of basis adjustment provisions that yield income tax benefits without negative estate tax consequences. The changes made under the Tax Act may only be temporary, thereby creating uncertainty for some. Managing that uncertainty with thoughtful planning can yield substantial long-term benefits.

Contact Us

For more information on how the proposed changes may affect you, please contact a member of Husch Blackwell's Private Wealth team.