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Estate Planning In Light of the Tax Cuts and Jobs Act

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Our Trusts and Estates attorneys have been closely monitoring The Tax Cuts and Jobs Act, which was signed into law by President Trump on December 22nd. We have been assessing the impact of the new law on our clients and considering the estate planning opportunities and challenges it presents for many of our clients.

Under the new law, the federal gift and estate tax exemption amount is doubled to $11.2 million per person, effective January 1, 2018. Individuals may use their lifetime exemption to make tax-free gifts during life or shield transfers at death from estate tax up to $11.2 million. Portability of the exemption between spouses continues under the new law, meaning a married couple can shield $22.4 million from estate taxation. If one spouse does not use all of his or her $11.2 million exemption, it may be carried over and used by the surviving spouse for lifetime transfers or at death, provided the predeceased spouse's representative makes a portability election on a timely filed estate tax return. For 2019 and future tax years, there is potential for future inflation adjustments. The tax rate remains at 40%.

Along with the estate tax exemption, the generation-skipping transfer ("GST") tax exemption is likewise doubled, enabling families to leverage the exemption over multiple generations. As under current law, GST tax exempt assets held in trust can remain exempt for an unlimited duration and therefore not subject to estate tax in future generations. Now might be an opportune time to consider setting up a legacy trust, which can shield assets from both taxes and the reach of creditors. Creditor protection may be particularly important to ensure the future care and support of beneficiaries with mental health or addiction concerns, as well as those with spendthrift habits or who may be facing divorce.

Meanwhile, the annual gift tax exclusion increased to $15,000 per person in 2018, as scheduled under prior law. Clients with an established gift-giving program previously motivated by tax considerations may want to reevaluate whether gifting continues to make sense. Alternately, clients who have previously exhausted their exemption amounts may want to consider additional lifetime gifting techniques to take advantage of their newly increased exemption while it is available. Finally, there are additional incentives to make gifts for educational savings under the new law[1]. Distributions from 529 plans have been broadened to include expenses for private or religious elementary and secondary school educational expenses, making 529 plans more versatile. Concern that a child or grandchild would not attend college often hindered clients in making gifts to 529 plans. Expanding the permissible (i.e. tax free) distributions from these plans will likely allay this concern for many clients.

As with the Bush-era tax cut, the *Economic Growth and Tax Relief Reconciliation Act of 2001*, the individual tax cuts will expire after 2025. The sunset provision was necessary to comply with budget rules, which do not allow tax legislation to add to the deficit after a decade. The gift and estate tax provisions are among the individual tax cuts that will sunset and revert to current law on January 1, 2026. In addition, it is possible that the Tax Cuts and Jobs Act will be repealed or that the exemption amount will be lowered beyond current levels by a subsequent Congress. So while the new law presents significant planning opportunities, the temporary nature of the law lends a dose of uncertainty to any planning that is to be undertaken and cautions careful consideration of unintended consequences.

For many clients, their estate plans can be greatly simplified. With tax avoidance no longer a driving factor, clients can tailor their planning to other important goals such as asset protection, planning for incapacity and income tax planning to take advantage of the step up in basis allowed at death. For clients with family businesses, minor children or loved ones with special needs, the focus of their planning will likely stay the same and not be impacted greatly by the new tax law. For other clients, the increased exemption has opened up new opportunities for transferring and preserving wealth. In addition to lifetime gifting and creation of legacy trusts, short-term planning techniques, such as grantor retained annuity trusts (GRATs) or qualified personal residence trusts (QPRTs) whose terms end before the expiration of the tax cuts, may be particularly effective for very high net worth clients. Where appropriate, leveraged transactions involving gifts or sales of discounted assets may permit clients to further capitalize on the new exemption amount.

While it is estimated that less than 2,000 estates per year will be subject to the federal estate tax under the new law, many more are currently subject to state estate tax and will continue to be. In contrast to federal tax law, the Massachusetts estate tax remains unchanged with an exemption amount of $1 million. Massachusetts is currently tied with Oregon for the lowest state exemption in the country. In addition, 16 other states and Washington D.C. impose a state estate and/or inheritance tax[2]. Clients who are domiciled or own property in these states will continue to have to plan for state estate taxes. Moreover, Massachusetts and many other states with state estate tax regimes do not permit portability, making planning to capture both spouse's exemptions critical. Five states have tied their state estate tax to the federal tax, whatever it is, delivering an unintended benefit to residents. It is unclear how states may adjust their estate tax systems based upon the new law and there will likely be a period of uncertainty during which there may be opportunities to strike while the law is certain.

Most estate plans should be evaluated in light of this far-reaching tax law. Beyond the tax considerations, however, clients should always routinely assess their planning to be sure it meets their current goals and wishes, since estate plans should never be driven solely by estate taxes. Far more wealth is lost to financial mismanagement, lawsuits, divorce, spendthrift heirs and the costs of long term care, than from estate taxes. Lastly, given the temporary nature of these changes and the unpredictability of future administrations, the best estate plan should build in adaptability to changing laws and circumstances. If you would like to schedule a meeting to evaluate the impact of the new law on your personal estate plan or would simply like to talk over the current structure of your estate plan, please be in touch.

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[1]An added quirk of the new law now permits a 529 account to be opened for a child in utero, allowing clients to get a jump start on their educational gift-giving!

[2]States with an estate tax in 2018: Connecticut, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New York, Oregon, Rhode Island, Vermont and Washington. States with an inheritance tax in 2018: Iowa, Kentucky, Maryland, Nebraska, New Jersey and Pennsylvania.

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