How Does Tax Reform Affect Your Estate Plan?

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In December 2017, a sweeping tax reform bill, commonly known as the Tax Cuts and Jobs Act of 2017 (TCJA), was passed by Congress and signed into law by the President. The TCJA reduces individual and corporate tax rates, eliminates a host of deductions, enhances other breaks, and makes numerous other changes. But how does the TCJA affect your estate plan?

One thing the TCJA did not do is repeal the federal gift and estate tax, as initially planned by the House of Representative’s version of the bill. Instead, the TCJA temporarily doubles the combined gift and estate tax exemption and the generation-skipping transfer (GST) tax exemption from $5 million to $10 million (adjusted for inflation after 2011). For 2018, the exemption is now $11.2 million per person ($22.4 million for a married couple). This doubled exemption will adjust for inflation each year and will remain in effect until December 31, 2025. If Congress doesn’t act before 2026, the law will sunset and the exemptions will revert to the $5 million level (indexed for inflation).

New Estate Planning Opportunities

These changes open considerable opportunities for people to remove assets from their taxable estates and permanently exempt future appreciation of those assets from estate, gift, and GST tax. For example, by using the increased exemption amount to make tax-free lifetime gifts, you can protect that wealth (and any future appreciation in value) from taxation in your estate, even if smaller exemptions are reinstated before death. Be aware though, that unlike assets transferred at death, lifetime gifts will not receive a stepped-up tax basis. This could cause an increase in income taxes on any gain realized by the recipient when they sell the gifted asset. It is therefore critical to weigh the potential estate tax savings against the potential income tax costs when considering this strategy.

Lifetime Gifting Strategy with 529 College Savings Plan

If you can benefit from a lifetime gifting strategy, then you may want to consider combining that strategy with a 529 college savings plan. The TCJA permanently expands the benefits of these plans, which now permit tax-free withdrawals for qualified elementary and secondary school expenses and not just higher-education expenses. Contributions to 529 plans are removed from your taxable estate even though you can change the beneficiaries at any time and even get your money back (Note: a penalty will be assessed for any non-qualified distributions). And, you can combine 5 years’ worth of annual gift tax exclusions (currently $15,000 per year) into one year, so an individual could gift $75,000 to a 529 plan this year (or $150,000 for married couples) without triggering gift or GST tax or using any of your exemptions.

Dynasty Trust

It may also be an ideal time to establish a "Dynasty trust." Significant amounts of wealth can grow and compound free of federal estate, gift, and GST tax with this type of irrevocable trust, providing tax-free benefits for your grandchildren and future generations. In Maryland and a few other states, a dynasty trust can last forever, but some states restrict the length of time these trusts can exist. Avoiding the GST tax is imperative as it imposes an additional 40% tax on transfers to grandchildren and others that skip a generation. Clearly, this tax will quickly erode large amounts of wealth. The key to avoiding the GST tax is to leverage your new, doubled GST tax exemption.

For example, let's assume that you have not yet used any of your estate and gift tax exemptions and you transfer $10 million to a properly-crafted dynasty trust. There would be no gift tax because you are within your exemption amount. Now, the funds in the dynasty trust, and all future appreciation of those funds, are out of your taxable estate. Then, by allocating your GST tax exemption to your $10 million trust contribution, you can ensure that any distributions from the dynasty trust to your grandchildren (or subsequent generations) avoid GST tax. This is true even if the trust's funds grow well beyond the exemption amount and even if the exemption amount is reduced in the future.

Other Estate Planning Considerations

Keep this in mind though: estate, gift, and GST tax planning is only one aspect of estate planning. Given that some pundits are predicting that the TCJA has reduced the number of U.S. estates subject to estate tax from approximately 5,000 to 2,000, most families should likely focus more on non-estate tax issues, like incapacity planning, asset and nursing home protection, guardianship of minor children, blended family issues, special needs children planning, business succession planning, and minimizing income taxes.

In fact, it may be preferable to engage in strategies to reduce income tax now and then transfer those savings to your beneficiaries at death with as little transfer tax as possible. This can be done in a variety of ways, including, but not limited to:

- Shifting income to someone else: make a lifetime gift of an asset that produces a lot of income to a trust that distributes the taxable income to a beneficiary that is in a lower tax bracket;
- Charitable giving: contribute more to charity. The TCJA increases the adjusted gross income limitation for deductions of cash donations to public charities from 50% to 60%; and
- Delaying capital gains taxation: make a gift of an asset that has already appreciated and that you want to sell to a charitable remainder trust (CRT). A sale by the CRT avoids immediate capital gains taxation. 100% of the proceeds of the sale are then reinvested. Distributions from the CRT each year will be taxed to the beneficiary, but may avoid income taxation at top rates.

The TCJA is perhaps the most significant tax legislation in over 30 years. Continued review and experience with the Act will unquestionably reveal numerous new planning opportunities in the coming months and years. Don't fall into the trap that you don't need a well-crafted estate plan because of the increased federal estate, gift, and GST tax exemption. Current estate plans may not have the intended consequences under the new rules, and no one should wait for a death to find out if they have a good estate plan.

David A. Lucas is an Attorney in Miller, Miller & Canby’s Estates & Trusts and Business and Tax Practice Groups. David is committed to providing his clients with a well-crafted estate plan so they may avoid probate, protect their assets and legacies, and provide for the security of their loved ones. He takes a special interest in ensuring that the dreams parents have for their children and grandchildren are not lost to taxes, poor planning, or procrastination. He speaks frequently on a variety of estate planning topics to both the general public and private groups.

David has focused his practice on helping families preserve their financial wealth and legacies for future generations through the use of Trusts, Wills, Powers of Attorney, Advance Medical Directives, Living Wills, and other estate planning strategies.

Contact David to discuss your estate plan to take advantage of the laws available today and ensure flexibility for future changes. For more information on Miller, Miller & Canby’s Estates & Trusts Practice, **click here**.