



Investment Management Group

## Attorney/CPA Corner Estate Planning Update

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### Greetings

*Northwest Bank's Investment Management Group would like to help you stay informed on the issues shaping your clients' financial and estate planning needs.*

*If we can be of any assistance please contact one of our estate and financial planning professionals. We look forward to working with you.*

### Estate planning, 2018 through 2025

For most of tax reform's legislative process last year, the bill was known as the "Tax Cuts and Jobs Act." Just before finalization, the Senate Parliamentarian ruled that having a legislative nickname fell outside the budget rules for the legislation, and the name was removed. Nevertheless, the name TCJA has survived in much of the commentary.

The key estate planning changes can be easily stated:

- a doubled federal exemption from estate and gift taxes;
- the increase expires in 2026, along with all the other changes affecting individuals.

The 2018 estate tax exemption is expected to be \$11.2 million, double what the IRS announced last fall for this year. However, a close reading of the legislation casts some doubt on that figure. The new method of calculating inflation for changing the tax code, which is expected to reduce future revisions, may alter the final exemption figure.

### Estate planning simplified?

According to a report from the Congressional Research Service, under the old law only 0.2% of estates were likely to be taxable each year. Doubling the federal estate tax exemption is expected to reduce that figure to 0.05%. However, excusing 75% of the estates that would have been taxable in 2017 from being taxable in 2018 will not have a proportionate impact on the collection of estate tax revenue. The lion's share of estate taxes are paid by estates of \$50 million and more. For these estates, the doubled exemption will be welcome but hardly revolutionary.

### More from the Congressional Research Service:

- With the larger exemption, only 25 farm estates are projected to be taxable each year, or one per state every other year. This formulation overlooks the number of farms disposed of before death in order to avoid death tax trouble.
- Under the prior law, about 94 estates each year were estimated to have half of their assets in a family business that heirs were expected to continue. This number will fall by an unknown factor with the larger exemption.

Although the fear of federal estate taxes has largely been removed for most families, estate planning and review of existing plans are as urgent as ever.

**Intestacy.** The most important objective of estate planning always has been, and continues to be, to provide a thoughtful plan for property disposition, avoiding the arbitrary rules of the state intestacy statutes.

State death taxes. The minority of states that continue to impose an inheritance or estate tax at death generally have exemptions far lower than that provided by the federal government.

**Formula clauses.** Estate plans for married couples have routinely used formulas to measure amounts going to marital trusts or credit shelter trusts. Those plans need to be reviewed, to make certain that the formula does not produce an unintended result with the doubled federal exemption.

**Basis planning.** The income tax will be an important driver of planning for small and medium estates. Tax-free basis step-up at death, reducing the taxes on capital gains for heirs, should be taken into account with any program of lifetime giving.

Hence, estate planning is not really getting much easier, even for federally nontaxable estates.

## DSUE

We should see a spike in the filing of nontaxable estate tax returns in the next few years. Every surviving spouse should insist that a return be filed to make the election for a Deceased Spouse's Unused Election Amount. The DSUE, which could be \$11.2 million or more, should continue to be available to the surviving spouse in 2026 and later years, even if the enlarged exemption expires on schedule. With the election in place, the surviving spouse's estate will have roughly \$18 million of shelter from federal transfer taxes.

## Locking in the larger exemption

Another way to beat the scheduled expiration of the larger gift tax exemption is to make a lifetime gift to use it up before 2026. If the estate tax exemption is reduced as scheduled, tax savings of several million dollars could be achieved by making irrevocable gifts of assets before that happens. TCJA includes a direction for the IRS to provide instructions on what happens if the exemption is reduced in the future.

Simplified example. Jim, a single taxpayer, makes a gift in 2018 of \$11.2 million to his heirs. No gift tax is due, thanks to the doubled exclusion. Jim then dies in 2026, when the estate tax exemption is only \$6 million, and his estate is then worth only \$1. Theoretically, then, Jim's estate will owe an estate tax on the \$11.2 million, minus his \$6 million estate tax exemption. If his estate has to pay a tax on the \$5.2 million difference (about \$2 million), the benefit of the larger exclusion would be "clawed back" by the IRS. If the estate already has been exhausted, it is unclear where the payment would come from. Most tax commentators do not believe that will happen, that the larger exemption will be preserved for gifts actually made in reliance upon it. We won't know for certain until the IRS issues regulations on the subject, and that won't happen any time soon.

## Large estates

Estates of \$20 million and up will need to do some estate tax planning, even with the doubled exemption. The good news for these estates is that aggressive strategies remain available, such as gifts of minority interests in family limited partnerships, dynasty trusts, and short-term grantor retained income trusts.

A variety of strategies is available to "leverage" the federal estate tax exemption. For example, in the right circumstances the sale of a note to a defective grantor trust might be used to transfer over \$626 million tax free to heirs after 20 years [Appendix 7 of Estate Planning After the Tax Cut and Jobs Act of 2017 by Martin M. Shenkman, Esq., Jonathan G. Blattmachr, Esq., and Joy Matak, Esq.; Pre-publication draft].

Estate planners and their clients will have a lot to talk about this year.