WINSTEAD

Estate Planning Implications of the Tax Cuts and Jobs Act

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On December 22, 2017, President Trump signed the Tax Cuts and Jobs Act (the "Act") into law, ushering in some of the most sweeping changes to the Internal Revenue Code in over 30 years. While the Act substantially revises the income taxation of individuals and corporations, this alert focuses on the transfer tax changes that took effect in 2018. We have summarized these changes in the paragraphs below, along with their potential estate planning implications.

Increased Transfer Tax Exemption Amounts for 2018 through 2025

The bill originally introduced by the House of Representatives would have repealed the estate tax beginning in 2025. The Act does not repeal the estate tax, although it nearly doubles the estate, gift, and generation-skipping transfer ("GST") tax exemption amounts. Under current law, these exemption amounts were set to increase in 2018 to $5.6 million per person (or $11.2 million per married couple). The Act increases these exemption amounts in 2018 to approximately $11.18 million per person (or $22.36 million per married couple). Subject to certain exceptions, gifts, estates, and GST transfers in excess of $11.18 million (or $22.36 million per married couple) will continue to be taxed at a 40% rate.

The exemption amounts will continue to be indexed for inflation, but with a base year of 2016. Inflation will also be based on the "chained" consumer price index ("CPI"), rather than the traditional CPI, which should result in smaller annual inflation amounts moving forward.

While not part of the Act, it is also important to note that the gift and GST tax annual exclusions are set to increase in 2018 from $14,000 (where they have been since 2013) to $15,000.

Increased Exemption Amounts Sunset after 2025

Because Congress passed the Act through the "reconciliation" process and did not have a super-majority of 60 votes in the Senate, the Act could not add to the deficit beyond the 10-year budget window (the so-called "Byrd rule"). To comply with the Byrd rule, the increased transfer tax exemption amounts expire on December 31, 2025. Consequently, the exemption amounts will revert back to current levels beginning in 2026, although such exemption amounts will be indexed for inflation with a base year of 2016 in accordance with the chained CPI. It is important to remember, therefore, that these increased exemption amounts are not permanent, and could be reduced or eliminated prior to 2026 in a different political climate.

Estate Planning Implications

It is impossible to address all of the estate planning implications of the Act, which necessarily depend on each individual's unique circumstances. There are, however, some common themes, which we have outlined below:

- *Lifetime Gifting for Ultra-High Net Worth Individuals*. Nearly doubling the exemption amounts will eliminate estate taxes for a substantial number of persons who die between 2018 and 2025. Many estates, however, may still be subject to a 40% estate tax even with the increased exemption amounts. For these individuals, traditional wealth-shifting strategies such as installment sales to grantor trusts, grantor retained annuity trusts (GRATs), and leveraging exemptions through the use of valuation discounts, should continue to be viable estate planning tools. In fact, there will likely be a renewed emphasis on lifetime gifting for ultra-high net worth individuals and their families during this 8-year window when the gift tax exemption is temporarily increased.

- *Asset Allocations under Formula Bequests.* Many estate plans are structured with formula bequests based on the transfer tax laws in effect at an individual's death. For example, it is common for assets up to an individual's remaining estate tax exemption amount to pass to a bypass trust for the surviving spouse and children (or perhaps just the children in a second marriage situation), with the remainder passing to or for the benefit of a surviving spouse. Similarly, charitably inclined individuals may attempt to eliminate all estate taxes by passing their remaining estate tax exemption amount to friends and family members, with the remainder passing to charity. These asset allocations may still make sense with increased exemption amounts, or they may not. Individuals should review their existing estate plans to confirm that the potential allocation of assets under the Act meets with their intent.

- *Effective Use of GST Exemption.* Many individuals desire to structure their estate plans to benefit as many generations as possible. To this end, these individuals allocate GST exemption to certain trusts created during lifetime or upon death. Certain individuals even pass their remaining GST exemption amount to trusts for their grandchildren, with the remainder passing to trusts for children or other beneficiaries. Again, these formula bequests may not make sense with increased GST exemption amounts. If possible under the new law, it may be beneficial for individuals to allocate GST exemption to non-exempt trusts or accelerate GST transfers while the increased GST exemption amounts are in effect.

- *Insurance Planning.* Life insurance is an integral part of many estate plans, especially for families who may need liquidity to help satisfy a substantial estate tax liability attributable to an illiquid asset such as a closely held business, family farm, or ranch. These individuals should review their insurance coverage in light of the Act's increased exemption amounts to determine whether a reduction in insurance is warranted or, given the temporary nature of the increased exemptions, gift tax exemption should be utilized to purchase additional coverage. Business owners may also consider utilizing their increased exemptions to unwind outdated and inefficient split-dollar arrangements.

- *Income Tax Basis Planning.* As is the case under current law, assets included in an individual's taxable estate should continue to receive an income tax basis adjustment to fair market value as of the individual's date of death. With increased exemptions eliminating the estate tax concerns of many individuals, income tax planning can often be more important than estate tax planning. Individuals should review wealth-shifting strategies implemented under prior law to confirm that they are not detrimental from an income tax perspective. In certain circumstances, these transactions can be unwound or modified to minimize overall taxes upon death and pass additional wealth down generational lines.

- *Non-Tax Objectives.* In addition to considering the transfer tax impact of the Act, individuals, and particularly those with dated estate plans, should review their current estate planning documents to ensure that their non-tax objectives are being satisfied. Such non-tax objectives may include the designation of executors and trustees, the presence and amount of specific gifts to individuals and charities, and the use of trusts to provide beneficiaries with creditor and divorce protection.

Conclusion

While we hope that this alert is helpful in understanding the estate planning implications of the Act, please note that this is only a summary and does not address all details or contingencies.

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