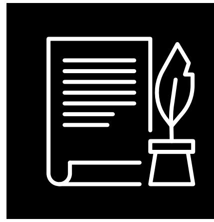

Estate Planning Strategies After Tax Reform

by Philip Herzberg, CFP®, CTFA, AEP®

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The tax cuts and Jobs Act (TCJA), passed on December 22, 2017, made sweeping changes to virtually all areas of federal tax law. Notably, the TCJA doubled the amount of property that can be gifted or passed upon death without incurring estate, gift, or generation-skipping transfer (GST) taxes to $11.4 million per individual and $22.8 million per couple in 2019. The caveat is that these increases, which are annually adjusted for inflation, may be temporary, with provisions lapsing after 2025.

As a financial planner, how can you optimally guide your clients in shifting more of their current wealth, and future appreciation on any transferred assets, to their heirs in a tax-advantaged manner? Note that the top federal estate, gift, and GST tax rate remains a flat 40 percent. Consider the following estate planning insights in light of the new tax law changes.

Minimizing Transfer Tax Value

Understand that the doubling of the estate, gift, and GST tax exemptions may provide your clients with viable planning opportunities to make large lifetime gifts while alive or after their death. Your clients are presently permitted to give up to $15,000 of assets or non-cash property ($30,000 for spouses splitting gifts) without counting toward their indexed lifetime gift exemption of $11.4 million.

Also, the portability election, which enables the carryover of a deceased spouse's unused estate and gift tax exemption amounts to the surviving spouse, is still available. Be mindful that portability only applies to the federal estate and gift tax exemptions and does not apply to the GST tax. The upshot is your clients can take advantage of the federal exemption portability election by shielding as much as $22.8 million of net worth.

Is it worthwhile for you to plan significant gifts now for your clients that otherwise may be payable in estate taxes in future years? Evaluate your grantors' gifting capacity, donative intent, and timing of their gifts to determine if they should make lifetime gifts now to lock in the increased exemption amounts.

Be wary of tax basis when looking at your clients' existing estate plans. Step-up in cost basis is a pivotal factor in deciding whether your clients should gift during life as compared to bequeathing assets. Recognize that the tax basis of an asset gifted during life is generally the carryover original purchase price. In effect, gift recipients may be subject to an unanticipated income tax liability if they choose to sell a donated asset that further appreciates in value. On the other hand, if an asset is held until death, the asset's cost basis is stepped up to the fair market value when received by the heir at the time of death.

If your clients have previously gifted assets with low income tax basis to irrevocable trusts, those assets will not receive a step-up basis upon their death. Think about substituting high-basis

assets if trusts included power of substitution provisions. In tandem with an estate planning attorney and qualified tax professional, you should review your clients' asset protection strategies.

Reviewing Estate Planning Documents

The increased exclusion amount may drastically change the intended results of current estate plans, especially older plans that have not been updated after 2012. It is important to review your clients' existing estate planning agreements to ensure they do not contain formula provisions that could create an unfavorable and unintended distribution for those who now have nontaxable estates. Formula clauses must be revisited to confirm that the intent of the grantor is consistent with the language in the documents. These clauses attempt to fully use any unused exclusion amount that may be available at death by allocating assets to a trust or to a specific non-spouse beneficiary.

For example, many plans for married couples may have stipulated the automatic funding of a "credit shelter" or "bypass" trust at the first spouse's death using a formula based on the applicable exclusion amount. Unless the plan is updated, these clauses may result in less-than-optimal use of the deceased spouse's exclusion and sacrifice the opportunity for a step-up in cost basis at the surviving spouse's death. In some situations, the credit shelter is intended to benefit the children or grandchildren, rather than, or in addition to, the spouse with any additional assets going outright to the surviving spouse or a marital trust. Essentially, the increased exemption may result in all or a majority of the assets being used to fund the trust with little or no assets left to the surviving spouse.

In addition, you should review your clients' character of assets and net worth, which may have changed significantly from their original estate plan. If the value of your clients' assets has changed considerably or the types of assets they own are concentrated in illiquid assets, they may now require planning for disposal of these assets at death or the use of ownership entities to manage for future generations.

Be sure to pay close attention to the titling of your clients' assets, as you review their estate plans. Depending on the provisions of their estate plan, married couples should have sufficient assets in their own names to fully utilize the estate and GST exemptions at death.

Leveraging Wealth Planning Techniques

Would your single or married clients with estates ranging from $5 million to $25 million or more be comfortable making large gifts now without retaining any rights to receive income or principal from those gifts? Your clients may be reluctant to make lifetime gifts to an irrevocable trust due to the loss of control over the donated assets or concerns that this gifting will deplete their funds to the extent they will no longer be able to maintain their accustomed standard of living.

Leveraging a spousal lifetime access trust (SLAT), which is a form of an irrevocable trust that is funded during the donor's lifetime using annual exclusion gifts and taxable gifts, may alleviate these concerns for your married clients. A SLAT enables a donor spouse to make a gift to an irrevocable trust in which his or her spouse is named as the lifetime beneficiary. A gift to a SLAT constitutes a completed gift, removing both the asset and any future appreciation from the donor spouse's estate while still retaining a degree of control over the assets through the beneficiary spouse for as long as they remain married. Consequently, SLATs can be a viable technique to capture the increased exemption amount without losing access to the gifted assets.

Similarly, you can use a grantor retained annuity trust (GRAT) to lock in the basic exclusion amount, should it be reduced in the future. GRATs also freeze asset values of the gifts, so there are no transfer taxes on future appreciation of those gifted assets to their intended beneficiaries. Note that GRATs may be funded with an array of assets, including marketable securities, closely held business interests, private equity, or hedge funds.

> **Despite changes to the federal tax law, many states still have an inheritance and/or estate tax.**

Since GRATs are grantor trusts, there is a possible income tax advantage to funding them, as the donor will be responsible for paying the taxes on all income items ascribed to the trust property on their personal income tax return. Tax payments will further reduce the donor's estate while the assets possibly grow tax-free.

To enhance legacy planning for your clients and their families, you can consider utilizing dynasty trusts for them to transfer prodigious assets throughout multiple generations with minimal additional estate or future GST tax burdens. These irrevocable trusts enable substantial amounts of wealth to grow and compound free of federal gift, estate, and GST taxes, delivering greater wealth for your clients' grandchildren and future generations. Note that only some states and jurisdictions allow such long-lasting trusts, with the longevity of these dynasty trusts varying from state to state. It is becoming more common for these trusts to last for hundreds of years or even in perpetuity.

Estate Tax at the State Level

The following states collect their own tax on residents' estates:

State	Exemption Amount
Connecticut	$3.6 million
Delaware*	$5.49 million (for deaths in 2017)
District of Columbia	$5.6 million
Hawaii	$5.49 million
Illinois	$4 million
Maine	$5.7 million
Maryland	$5 million
Massachusetts	$1 million
Minnesota	$2.7 million
New Jersey**	$2 million (for deaths in 2017)
New York	$5.74 million
Oregon	$1 million
Rhode Island	$1.56 million
Tennessee***	$5 million (for deaths in 2015)
Vermont	$2.75 million
Washington	$2.193 million

Notes: * Repealed for deaths after Jan. 1, 2018. **Repealed for deaths on or after Jan 1, 2018. New Jersey still collects an inheritance tax. ***Eliminated as of January 1, 2016. North Carolina and Ohio repealed the state estate tax in 2013.
Compiled by *Journal* staff (source: nolo.com)

Considering State Taxes and Planning for Non-Residents

Despite changes to the federal tax law making fewer clients subject to the federal estate tax, many states still have an inheritance and/or estate tax. A number of states, such as New York and Illinois, are "decoupled" from the federal estate tax regime, meaning that their applicable exclusion amounts do not match the federal amounts (see the sidebar for more on this).

In conjunction with an estate planning lawyer, you should review your clients' estate plans to ensure gifts of the federal applicable exclusion amount will not result in a state estate tax being due for your clients upon the first spouse's death. If you choose to draft disclaimer trust provisions in your estate documents, you may want to think about language that funds a bypass trust with the state tax exemption amount at the first spouse's death. Qualified terminable interest property (QTIP) trust planning may also be available at a state level depending on the specific state's legislation. The merit of a QTIP trust is that it delivers flexibility in the allocation of your estate property while maximizing your tax saving benefits.

You may also find that in your clients' state of residence, their individual income tax position, which is the combined state and federal taxes, has changed under the new tax laws. Revisit the benefits of maintaining grantor trusts, which enable trust income to be reported by the grantor on a tax return, if the tax position is negatively impacted by the new tax laws. If appropriate and valuable for the clients' situation, you might turn off grantor trust status to allow the trustee to shift income in the most effective manner.

Be mindful that the exclusion amount has not increased for clients who are not United States citizens. Proper estate planning for non-U.S. citizen spouses remains critical in order to prevent unforeseen estate taxes.

Giving Charitably

Given the many changes in the federal income tax laws, you may wish to guide your clients to change their approach to philanthropy. While making lifetime gifts to charitable organizations does not use their lifetime exclusion, it does provide a means for shifting assets out of their taxable estate, as well as possibly providing income tax savings. Fewer people are likely to itemize deductions with a higher standard deduction of $12,200 for single filers and $24,400 for married couples filing jointly (2019 standard deduction amounts). Yet, larger donors, particularly those with higher incomes, may continue to benefit from itemizing charitable deductions.

Consider advising your clients to group several years' worth of their charitable contributions into a single year to help boost income tax savings. This can be accomplished in a tax-efficient manner through a one-time lump sum gift to a qualifying charitable organization or a large gift to a donor advised fund, which can then be distributed over several years.

If your clients are charitably inclined and are at least 70½ years old, you could encourage them to direct up to $100,000 per year from their traditional IRA to a qualified charity tax-free to fulfill their annual required minimum distribution. Made a permanent part of the tax law in late 2015, this qualified charitable distribution (QCD) strategy is more valuable after TCJA because the higher new standard deduction means fewer clients will be itemizing expenses and taking charitable contribution deductions. These charitable contributions will be excluded from your clients' gross income. Note that your clients cannot obtain a double tax break by taking a QCD and receiving an itemized deduction for a charitable gift.

Ultimately, by understanding and applying these pivotal estate planning and wealth protection pointers, you can maximize the timely benefits of these tax law changes for your clients and enhance the financial security of their future generations. ■