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Not So Simple Estate Planning Considerations After 2017 Tax "Simplification"

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In December 2017 when Congress passed and the President signed the new tax bill, often referred to as the "Tax Cuts and Jobs Act," there was a great deal of publicity about its impact on individual and business income taxes. What has not received a lot of publicity is what the Act did (and did not do) to the tax law affecting estate planning.

For transfers and deaths occurring between January 1, 2018 and December 31, 2025, the estate and gift tax exemption and the generation-skipping transfer tax exemption were both increased from $5,490,000 to $11,180,000 per person, and those exemptions will continue to be adjusted each year for inflation. As a result, during lifetime and at death, a married couple may now transfer a combined $22,360,000 to family and friends without any gift tax or estate tax.

From a planning perspective, the difficult aspect of this increase in the exemptions is that the increase is scheduled to expire in a little less than 8 years on January 1, 2026, and at that time the exemptions will bounce back to the 2017 amount of $5,490,000 adjusted for inflation.

Adding to the uncertainty caused by this scheduled bounce back is the fact that Congress and the President could change the exemptions to prior levels sooner than 2026 and we have several elections between now and then that could affect the probability of such an action.

However, this window of higher exemptions does provide a unique opportunity for those who have an extremely high net worth and can afford to make significant gifts. Couples with a combined net worth exceeding $11,000,000, unmarried persons with a net worth exceeding $5,500,000, and those who had fully utilized their estate and gift tax exemption through 2017, should consider making gifts, either outright or in various types of trusts, soon in order to take advantage of the increased exemptions before they expire.

Two tax rules which affect estate planning and remain unchanged by the Act are the portability election and the basis adjustment at death, both of which can provide significant tax benefits. The portability election allows the unused portion of the first deceased spouse's estate and gift tax exemption to carry over to the surviving spouse for use during lifetime or at death.

Assets inherited at death will continue to receive an income tax basis adjustment in the hands of the beneficiary to the fair market value at date of death, often referred to as a "step-up" or "step-down" in basis. When a beneficiary sells an inherited asset, this adjusted basis is what the beneficiary subtracts from the sales price to determine the taxable gain or loss. As a result, all pre-death gains on appreciated assets will escape income taxes when the beneficiary sells those inherited assets. This can place a premium on retaining certain appreciated assets until death.

This basis adjustment continues to apply at the first spouse's death to both spouses' interests in Wisconsin marital property, not just the one-half interest of the deceased spouse, which is a significant advantage for appreciated marital property.

As in the past, there is no basis adjustment at death for IRA, 401(k), or other qualified retirement plan benefits, nor is there a basis adjustment for gifted assets.

Existing estate plans that may be in the greatest need for review and revision are those that are more than 3 years old and use a complicated formula based on the estate and gift tax exemption for dividing property at death. Estate tax minimization was usually the driving force behind this approach. For many couples, their estate plan may be simplified or at least developed around the family instead of taxes.

As we wait to see what will happen with the exemption amounts, having a flexible estate plan that may be easily adjusted as the tax law changes is the best way to ensure that your objectives can be accomplished efficiently. That flexibility will come from plans that allow for changes to be made after the death of the first spouse through elections by fiduciaries and actions by beneficiaries.

The two most popular techniques that provide this flexibility use a disclaimer or a QTIP Trust. In a typical disclaimer plan, all of the deceased spouse's assets are left to the surviving spouse, and the surviving spouse is given the right to disclaim, that is to refuse to accept all or part of the assets, within 9 months after the decedent's death. The disclaimed assets then pass to a trust for the benefit of the surviving spouse, instead of the children, so that the spouse may still receive the economic benefits of the disclaimed assets. The disclaimer is normally only exercised if there is a tax benefit from doing so.

Another technique which provides flexibility is to have all or part of the deceased spouse's assets pass to a protective trust for the exclusive benefit of the surviving spouse which the Internal Revenue Code refers to as a Qualified Terminable Interest Property Trust or a QTIP Trust. The significant tax planning flexibility in a QTIP Trust estate plan is a result of the elections which may be made on the deceased spouse's federal estate tax return which is due 9 months after the deceased spouse's death and may be extended to 15 months after the deceased spouse's death.

Because of the uncertainty about the amount of the estate and gift tax exemption and the generation-skipping tax exemption in the future, keeping your estate plan up to date by meeting with your estate planning attorney regularly to discuss the changes in your family situation, the changes in your net worth, and the changes in the tax law is more important than ever. If it has been more than 3 years since you met with your estate planning attorney, it is time to get a meeting scheduled.

Making an Impact: Charitable Giving Under New Tax Law

Two of the most significant changes made in the Act were the increase in the standard deduction ($12,000 for a single person and $24,000 for a married couple for 2018) and the limitation of the deduction for state taxes to $10,000. As a result of these changes, fewer individuals will itemize their deductions. That makes it less likely that the tax deductibility of charitable gifts will result in an income tax benefit to donors. However, there are still several tax-advantageous ways to make charitable gifts that donors should be aware of, including:

1. Direct Transfers from IRAs During Lifetime. Anyone over the age of 70 1/2 can make direct charitable distributions from his or her IRA totaling up to $100,000 per year. As long as these qualified charitable distributions are made directly from the IRA custodian to the charity, these distributions are excluded from the donor's taxable income. In addition, these distributions to charities will count towards your required minimum distribution for that year. By reducing your taxable income, this technique may also reduce your Medicare premiums and lower income taxes on your Social Security benefits.

2. Naming Charities as Beneficiaries of Retirement Accounts. When individual beneficiaries receive distributions from an inherited retirement account, they will recognize income and pay income tax on these distributions, which reduces the benefit to them. That income tax is avoided if you instead leave your retirement account directly to charities due to their tax-exempt status and they will benefit from 100% of that distribution. In addition, your estate will receive a charitable deduction which will eliminate any estate taxes that would otherwise have been due in larger estates if the retirement account had been left to your heirs.

3. Bunching Charitable Gifts. With the increased standard deduction and the limitation of the deduction for state taxes, many taxpayers won't have enough deductions in a particular year to itemize deductions and therefore will lose the deduction benefit of their charitable contributions. Because of this, the bunching of charitable gifts in one year rather than making them over several years is gaining popularity. By doing so, taxpayers will maximize their total deductions in that year so that they exceed the standard deduction and they receive the tax benefit of those itemized deductions in excess of the standard deduction. If taxpayers want the charities to still receive the gifts spread out over future years, taxpayers may make their bunching contribution to a donor advised fund. Their charitable contribution will be deductible in the year it is added to the donor advised fund, and they may then direct the distributions from the fund to the charities over future years.

Birthday Milestones

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Age 55	Penalty-free distributions allowed from 401(k) if retired

Age 59-1/2	Penalty-free distributions allowed from IRAs and qualified plans, and Roth IRAs at least 5 years old
Age 60	Can apply for early Social Security under deceased spouse's earning record
Age 62	Can apply for early Social Security under own earnings record (benefits reduced)
Age 65	Apply for Medicare (Parts A and B) beginning 3 months before your birthday • Coverage begins the 1st of the month you turn 65 • If you are employed/covered by other insurance, you can enroll any time after 65
Age 66	Full retirement age for unreduced Social Security benefits
Age 70	Apply for Social Security to get maximum benefits
Age 70-1/2	Must start IRA minimum required distributions

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