Wealth Transfer Tax Planning Implications of the 2017 Tax Act

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On December 22, 2017, President Trump signed Public Law No. 115-97, formerly known as the Tax Cut and Jobs Act of 2017[1], into law (the “2017 Tax Act”).

Increase of Gift, Estate, and GST Exclusions and Exemptions in 2018

From a wealth transfer planning perspective, the 2017 Tax Act provides significant relief to many taxpayers.

Prior to the 2017 Tax Act, individuals were entitled to a $5 million estate and gift tax exclusion amount. This amount is indexed for inflation, and, in 2017, it was $5.49 million. In 2018, it was scheduled to increase, based on inflation adjustments, to $5.6 million. The 2017 Tax Act doubles the estate and gift tax exclusion amount to $10 million, and, as adjusted for inflation, it is expected to be approximately $11.2 million per person.[2] Based on these amounts, a married couple would be able to transfer a combined $22.4 million free of estate and gift tax.

The increase in the estate and gift tax exclusion amount was accompanied by a concomitant increase in the generation-skipping transfer (GST) tax exemption amount to $11.2 million. And, although it was not affected by the 2017 Tax Act, the gift tax annual exclusion increased, based on inflation, from $14,000 in 2017 to $15,000 in 2018. The chart below shows the changes in the estate, gift, and GST tax exemptions, the tax rates, and the gift tax annual exclusion from 2010 to 2018:

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Changes in Inflation Adjustments and “Chained” CPI

The uncertainty with respect to the exact amount of the increase in the estate, gift, and GST exemption amounts is the result of a change, adopted by the 2017 Tax Act, to methodology for calculating inflation-based adjustments. Under prior law, inflation adjustments were based on the Department of Labor Consumer Price Index for All Urban Consumers, whereas the new law is based on the Department of Labor Chained Consumer Price Index for All Urban Consumers. It is anticipated that the IRS will release updated inflation-adjusted items in January or February 2018. Clients who wish to make large gifts that may come close to consuming the full amount of their exclusion are cautioned either to make slightly smaller gifts or to wait until the inflation-adjusted numbers are released before proceeding.

Sunset in 2026 and Clawback

The increases in the estate and gift tax exclusion amount and the GST exemption amount will remain in place until December 31, 2025, and will revert to prior law ($5 million exclusion, as adjusted for inflation) in 2026.

This increase, followed by a possible reduction, is reminiscent of the experience we had at the end of 2012 when the $5 million exclusion was scheduled to drop to $1 million in 2013. At the end of 2012, Congress made the $5 million exclusion permanent, but the permanence was short-lived. Clients who wish to make large gifts to take advantage of the increased exemption are encouraged to make those gifts in 2018, as a future Congress or President may seek to repeal the current favorable tax benefit.

A question that was raised in 2012 in connection with the increase and then possible reduction of the estate and gift exclusion was whether the prior tax benefit could be subject to a “clawback” resulting in additional estate tax. The 2017 Tax Act includes a new provision directing the Treasury Department to prescribe regulations as may be necessary or appropriate to address any difference in the basic exclusion amount at the time of a gift and at the time of death. This is to deal with the possibility of a “clawback” (i.e., a prior gift that was covered by the gift tax exclusion at the time of the gift might result in estate tax if the estate tax basic exclusion amount has decreased by the time of the donor’s death).

Basis Adjustment at Death

The 2017 Tax Act makes no change to the rules regarding basis adjustments at death. Under current law, an asset’s basis is adjusted to equal fair market value as of the date of death. This is often referred to as a “step up in basis” at death. This is a very valuable tax benefit as it permits heirs to sell assets, after a person’s death, with little or no recognized capital gain. For example, if John purchases a share of stock for $100 in 1975 and, in 2018, John dies when the stock is valued at $500 per share, the basis in John’s stock is increased from $100 to $500. John’s heirs can sell the stock at his death for $500 and recognize no gain.

No Repeal of the Estate Tax

The House version of the tax bill provided for a repeal of the estate tax in 2025. It would have kept the gift tax at a 35% rate. These provisions were not contained in the Senate version of the bill and did not make their way into the conference bill that was ultimately approved.

What Should Clients Do?

Because of the significant changes in the estate tax laws, we encourage all clients to review and revisit their estate plans.

- For some clients, the substantially larger exemptions mean that their estates will no longer be subject to estate tax in the future. Those clients might consider unwinding more complicated, taxfocused trust structures and simplifying their estate plans.

- For clients with larger estates, the increased exemption means that they have additional opportunities to make gifts to children, grandchildren, and other beneficiaries without incurring gift tax.
- Clients with interests in closely-held businesses can consider additional planning involving the use of grantor retained annuity trusts (GRATs) or sales to grantor trusts.
- Clients may want to consider making late allocations of GST exemption to trusts that are not exempt from GST tax.
- Clients should review formula clauses where the amount passing to a class or group of beneficiaries is tied to the estate tax exclusion amount, as the significant increase may result in more passing to that group of beneficiaries than was originally intended.

Is Estate Planning Still Necessary?

Of course, estate planning remains necessary. A well-designed and well-implemented estate plan ensures the orderly distribution of wealth to family members and beneficiaries, whether there are significant tax consequences or not. The increase in the exclusion amounts eases the burden of estate taxes, but it does not make estate planning any less important.

We are finding that many clients are concerned about the orderly management and disposition of assets to their family members. Clients are using trusts to help ensure that their assets pass to their intended beneficiaries and are not subject to claims of "creditors or predators," that is, those who prey on those with wealth, including business or tort litigants, ex-spouses, and others.

We encourage our clients to review their estate plans in light of the new tax law. If you have any question about the new tax law, please contact any member of our team to schedule a meeting to review and discuss the planning implications for you and your family.

[1] The official title of the act is "To provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018" but will be referred to herein as the "2017 Tax Act."
[2] As noted below, the increase in the exemption amount is tied to inflation adjustments that also changed, so we are awaiting confirmation from the IRS and Treasury on the exact amount of the increase.

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