Estate Planning Strategies: How to Take Advantage of the New Federal Tax Reform

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At the end of last year, Congress passed major tax legislation, the Tax Cuts and Jobs Act (TCJA), that not only impacts your business and income taxes, but also your estate planning. The TCJA provides a temporary opportunity to transfer an unprecedented amount of wealth free of any federal gift, estate or generation-skipping transfer (GST) taxes.

Summary of New Exemption Levels

Effective January 1, 2018, the federal gift, estate and GST exemptions (i.e., the amount you can transfer free of any of these taxes) were doubled to $11,180,000 for a single individual and $22,360,000 for a married couple. These amounts also contain annual inflationary increases. As discussed below, Illinois does not have a gift tax, and this alone offers significant opportunities.

However, on January 1, 2026, the TCJA provisions related to federal gift, estate and GST exemptions "sunset" and revert to 2017 levels (with inflationary increases). In 2017, the exemptions were $5,490,000 for a single person and $10,980,000 for a married couple.

While the law may undergo additional changes between now and January 1, 2026, currently, the only way to take advantage of the increased exemptions is to enact planning strategies in advance of the sunset date. Outlined below are planning opportunities and pitfalls as a result of the TCJA.

Take Advantage of the Enhanced Exemption Levels Soon

The most obvious planning opportunity under the TCJA involves early and full use of the new exemptions. As with any gifting strategy, all income and future appreciation attributable to the gifted assets escapes future gift and estate taxation. Therefore, assuming that you have an appreciating asset base, the sooner you implement a planning strategy, the greater the amount of future appreciation that will be shifted out of your estate. Because the exemptions are now at historically high levels, rapidly appreciating assets will have an exponential impact on any gifting strategy.

Use Trusts When Gifting

As with any gifting strategy, assets may be gifted outright so that the gifted assets are fully controlled by the beneficiary, and thereby exposed to the beneficiary's potential creditors. Alternatively, assets may be gifted in trust, which provides the benefits of 1) protecting the gifted assets from the beneficiary's creditors, including the spouses of beneficiaries in the event of divorce, 2) determining the future use and control of the gifted assets, and 3) sheltering the gifted assets from future gift, estate and GST taxes through allocation of your GST exemption.

When planning with trusts, you also have great flexibility in determining who will be responsible for the payment of income taxes that are attributable to the assets in a trust. As an enhanced planning technique, trusts can be structured as "grantor trusts" in which the trust is disregarded for income tax purposes, and you - not the trust or the beneficiaries - are responsible for paying tax on the trust's income. In essence, by structuring a trust as a
grantor trust, you can make further tax-free gifts to your beneficiaries by paying the income taxes incurred by the trust. This technique promotes appreciation of the assets in the trust while simultaneously decreasing the size of your estate, thereby producing additional estate tax savings.

**Gift Some Assets, Sell Even More Assets to Grantor Trusts**

For additional estate tax benefits, you can combine a gift of assets with a sale of additional assets. Because you are treated as the owner of a grantor trust for income tax purposes, if you sell assets to a grantor trust, there would be no capital gains tax attributable to the sale. Typically, you as the seller would finance the sale portion of the transaction in the form of a promissory note that the grantor trust would pay back to you over time (providing you with cash flow from the trust). The growth on the assets would then be outside of your estate tax base.

**Make Gifts to Spousal Lifetime Access Trusts**

Most people would consider $11,180,000 to be a very large gift and either cannot, or do not want to, give away this much money, as they may need or want it for themselves. A gift to a properly structured "spousal lifetime access trust" lets you make a completed gift now, utilizing the increased exemptions, but keeps your spouse as a beneficiary of the trust, thus providing access to funds if needed. The assets of the trust (and the growth thereon) will not be included in your or your spouse's taxable estate at your deaths.

**Account for the State of Illinois**

Unfortunately, Illinois continues to tax estates in excess of $4,000,000. This exemption level is not scheduled to increase with inflation and is not portable between spouses. An Illinois decedent having an estate valued at $11,180,000 would owe no federal estate tax, but would owe approximately $1,080,000 in Illinois estate tax. Therefore, planning for the estate tax in Illinois (or any other applicable state) cannot be ignored.

The obvious and most direct strategy to address the Illinois estate tax is to simply move to a state that does not impose an estate tax (e.g., Florida). Please contact us for a list of estate tax "friendly" states. In the event that a change of domicile is not possible or is not desired, all of the traditional planning techniques described in this alert (in addition to others) are available to address this state liability. One final and important note: Illinois does not impose a gift tax. As a result, enacting gifting strategies may result in a reduction of future Illinois estate taxes.

**Review Estate Plans**

All existing estate plans and titles of assets should be reviewed now. Many estate plans contain tax-related terms and formulas that are tied in some way to the federal estate tax laws. Because of the highly expanded exemption levels under TCJA, many of these plans may now be outdated or may produce unintended consequences. Similarly, now is a good time to review the title of your assets and all beneficiary designations.

**Plan for Income Tax Basis Changes**

TCJA made no changes to the tax laws providing an income tax basis adjustment for assets received from a decedent upon his or her death (commonly known as the "step-up in basis"). With the increase in the federal gift, estate and GST exemptions, and even with the State of Illinois' $4,000,000 exemption, in many circumstances transfer taxes are no longer a concern and there is increased emphasis on income tax planning (specifically, planning with the goal of obtaining an income tax basis step-up at death). For many clients, it may be advisable to "reverse" prior estate planning techniques, including trusts that were established on the death of a first spouse to die.

**Don't Forego Traditional Estate Planning**

Regardless of whether the new exemption levels under TCJA are helpful to you, everyone still needs to address their estate plans from time to time. Everyone has different estate planning goals. Many people no longer have taxable estates for federal estate tax purposes and may be able to adjust their estate plans accordingly. Others may have existing plans that automatically adjust to the increased exemptions and do not desire more aggressive planning. Others may want to take prompt action to aggressively utilize the new exemptions.

The above summary is not intended to list all of the issues raised by TCJA or to enumerate all of the available estate planning techniques, which are well beyond the scope of this alert. Non-tax reasons to review and implement estate plans include:

- Planning for probate avoidance
• Planning for individuals with special needs (or otherwise require specialized planning)
• Implementing advance health care directives (such as living wills and health care powers of attorney)
• Planning for incapacity
• Business succession planning
• Planning for minor children and designating guardians
• Charitable planning

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